Domtar.
A Different
Feel.

What about the numbers?

Annual Report 2002 Financial section

Domtar

The common shares of Domar Inc. are listed on the Toronto Stock Exchange and the New York Stock Exchange. Domtar is therefore subject to the listing requirements of these stock exchanges and the securities laws of Canada and the United States.

As required by the Sarbanes-Oxley Act enacted by the U.S. Congress in July 2002 and the rules promulgated by the U.S. Securities and Exchange Commission (SEC) thereunder, we have filed with the SEC certificates relating to, among other things, the accuracy of the financial information contained in Domtar's 2002 annual report and the adequacy of our procedures and controls relating to disclosure and financial reporting.

Copies of these certificates can be viewed on the SEC website at www.sec.gov.

Raymond Royer
President and Chief Executive Officer

Christian Dubé
Senior Vice-President and Chief Financial Officer

What about the numbers?

Just how did Domtar achieve so much in 2002? (see reverse)

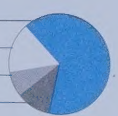
Cover page:
Ibtissame Guitouni, Agent - General Ledger
Finance Shared Services Centre

Management's discussion and analysis

Management's Discussion and Analysis (MD&A) relates to the financial condition and results of operations of Domtar Inc. and its subsidiaries (the Corporation) as well as its joint ventures (collectively Domtar). Domtar's common shares are listed on the Toronto and New York stock exchanges. The MD&A contains statements that are forward-looking in nature. Such statements involve known and unknown risks and uncertainties, such as: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency exchange rates, our ability to integrate acquired businesses into our existing operations, and other factors referenced herein and in the Corporation's continuous disclosure filings. Therefore, the actual results of the Corporation may be materially different from those expressed or implied by such forward-looking statements. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars and determined on the basis of Canadian generally accepted accounting principles (Canadian GAAP). This MD&A should be read in conjunction with the Corporation's consolidated financial statements and notes thereto.

Our business

Net sales by segment



[1] Including sales of Domtar papers through our Paper Merchants business.
[2] Excluding sales of Domtar papers.

Domtar's reporting segments correspond to the following business activities: Papers, Paper Merchants, Wood and Packaging.

Papers

We are the third largest integrated manufacturer and marketer of uncoated freesheet paper in North America. We operate six pulp and paper facilities in Canada and five in the United States, with an annual paper production capacity of approximately 2.8 million tons of paper, which are complemented by strategically located warehouses and sales offices. More than 50% of our paper production capacity is located in the United States and approximately 85% of our paper sales are generated in that country. Uncoated and coated freesheet papers, our principal products, are used for business, commercial printing and publication, and technical and specialty applications. The chart below illustrates our principal paper products and our annual paper production capacity.

Categories	Business Papers		Commercial Printing and Publication Papers			Technical and Specialty Papers
Types	Uncoated Freesheet				Coated Freesheet	Uncoated and Coated Freesheet
Grades	Copy	Premium imaging / Technology papers	Offset Business converting	Lightweight Opaques Text, cover and writing	Lightweight Premium Regular	Flexible packaging Abrasive papers Decorative papers Imaging papers Label papers Medical disposables
Applications	Photocopies Office documents Presentations		Pamphlets Brochures Direct mail Commercial printing Forms & envelopes	Stationery Brochures Annual reports Books Catalogues	Brochures Annual reports Books Magazines Catalogues	Food & candy wrappings Surgical gowns Repositionable note pads Security check papers Wallpapers
Capacity*	As at January 1, 2003:		2.8 million tons			
	0.8 million tons 29%	0.2 million tons 7%	0.6 million tons 22%	0.4 million tons 14%	0.4 million tons 14%	0.4 million tons 14%

*The allocation of production capacity may vary from year to year in order to take advantage of market conditions.

Our business (continued)

We sell paper primarily through a large network of owned and independent merchants which distribute our paper products from over 350 locations throughout North America. We also sell our products to a variety of customers including business offices, office equipment manufacturers, retail outlets, commercial printers, publishers and converters. In addition, we sell pulp produced in excess of our internal requirements (net position), which was approximately 630,000 tons in 2002.

Our Papers business is our most important segment and represented 59% of our consolidated net sales in 2002, or 65% when including sales of Domtar paper through our own Paper Merchants business.

Paper Merchants

Our Paper Merchants business comprises the purchasing, warehousing, sale and distribution of various products made by us as well as by other manufacturers. These products include business and printing papers, graphic arts supplies and certain industrial products. Our Canadian paper merchants operate a total of eight branches in eastern Canada (Buntin Reid in Ontario, JBR/La Maison du Papier in Québec and The Paper House in the Atlantic Provinces) while our US paper merchant (RIS Paper) services a large customer base from 20 locations in the Northeast, Midwest and the Mid-Atlantic regions of the United States. Our Paper Merchants business represented 22% of our consolidated net sales in 2002, or 16% when excluding sales of Domtar paper.

Wood

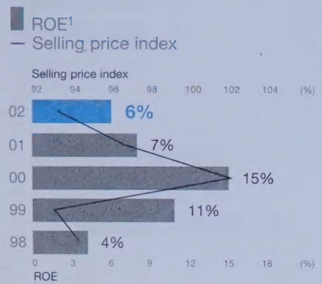
Our Wood business comprises the manufacture and marketing of lumber and wood-based value-added products as well as the management of forest resources. We operate 11 sawmills, one planer mill and one remanufacturing facility, with an annual capacity of 1.2 billion board feet. We also have a participation in three partnerships/joint ventures. We seek to optimize forestlands for which we are responsible through efficient management and the application of certified sustainable forest management practices such that a continuous supply of wood is available for future needs. Our Wood business represented 8% of our consolidated net sales in 2002.

Packaging

Our Packaging business comprises our 50% ownership interest in Norampac Inc. (Norampac), a joint venture between Domtar Inc. and Cascades Inc. The Board of Directors of Norampac is composed of four representatives from each of Domtar Inc. and Cascades Inc. The Chairman of the Board is a Domtar Inc. representative while the President and CEO is a Cascades Inc. representative. Norampac's debt is non-recourse to Domtar Inc. As required by Canadian GAAP, we account for our 50% interest in Norampac using the proportionate consolidation method.

Norampac's network of 25 corrugated packaging plants, strategically located across Canada and including facilities in the United States and Mexico, provides full-service packaging solutions and produces a broad range of products. These facilities are fully integrated on a direct or indirect basis with Norampac's eight containerboard mills that have a combined annual capacity of more than 1.6 million tons. Our Packaging business represented 11% of our consolidated net sales in 2002.

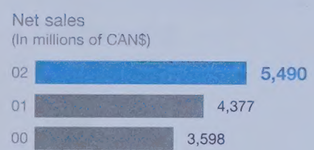
Summary of operating results

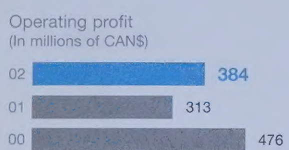


Financial highlights (In millions of Canadian dollars, unless otherwise noted)

Years ended December 31	2002	2001[1]
Net sales	**5,490**	4,377
EBITDA	**809**	607
Operating profit	**384**	313
Operating profit excluding Closure Costs	**447**	313
Net earnings	**141**	140
Net earnings per share (basic)	**0.62**	0.72
ROE (%)	**6**	7
Net sales allocation by segment (%):		
Papers	**59**	51
Paper Merchants	**22**	27
Wood	**8**	9
Packaging	**11**	13
Total	**100**	100
Selling price index (%)	**93**	97

2002 highlights





Net sales of $5.5 billion

Net sales for 2002 totaled $5,490 million, up $1,113 million or 25% from net sales of $4,377 million in 2001. This increase was mainly due to the inclusion of net sales of the four U.S. integrated pulp and paper mills (the Acquired Mills) acquired on August 7, 2001 (the Acquisition) for twelve months in 2002 compared to five months in 2001. The inclusion of our share of net sales of Norampac's recent acquisitions also contributed to the increase. Excluding the impact of these acquisitions, net sales in 2002 would have decreased by $22 million over 2001 mainly due to lower product prices, partially offset by higher shipments in all of our businesses, except for containerboard, and the positive impact of a stronger U.S. dollar. Benchmark nominal prices for 2002 were at 93% of trend compared to 97% in 2001. (See "Sensitivity analysis".)

Operating profit of $384 million

On March 27, 2002, we announced plans to permanently shut down the St. Catharines, Ontario, paper mill. The shutdown of this paper mill, which occurred at the end of September 2002, resulted in a charge to first quarter 2002 earnings of $45 million ($30 million net of income taxes, or $0.13 per common share). This charge included $14 million related to the write down to the estimated net realizable value of property, plant and equipment as well as $31 million of charges for other commitments and contingencies. These closure costs will be referred to as "Paper Closure Costs".

Also on March 27, 2002, we announced the shutdown of a paper machine at the Nekoosa, Wisconsin, paper mill resulting from a study, initiated at the time of the Acquisition, which reviewed overall paper machine capacity, market demand and respective paper manufacturing costs across all mills. Charges related to the closure of this paper machine, amounting to $10 million, were accounted for as part of the purchase price and allocated to the assets acquired and liabilities assumed as of the acquisition date, in accordance with Canadian Institute of Chartered Accountants (CICA) recommendations, and thus had no impact on 2002 earnings.

[1] Figures have been restated following the application of amended accounting recommendations that are described in "Accounting Changes".

2002 highlights (continued)

On November 29, 2002, we announced the permanent closure of our wood products remanufacturing facility in Daveluyville, Québec, and our hardwood lumber operation in Sault Ste. Marie, Ontario. These closures resulted in a charge to fourth quarter 2002 earnings of $18 million ($12 million net of income taxes, or $0.05 per common share). This charge included $13 million related to the write down to the estimated net realizable value of property, plant and equipment as well as $5 million for other commitments and contingencies. These closures, which occured at the end of January 2003, will be referred to as "Wood Closure Costs".

The Paper Closure Costs and Wood Closure Costs are referred to in aggregate as "Closure Costs".

Cost of sales increased by $807 million in 2002 or by 23% compared to 2001. This was mainly due to the inclusion of cost of sales of the Acquired Mills for twelve months in 2002 compared to five months in 2001, to our share of Norampac's cost of sales related to recent acquisitions, and to higher shipments in all of our businesses other than containerboard. This increase was partially offset by lower purchased fiber and energy costs as well as by a $16 million investment tax credit related to research and development expenditures for prior years.

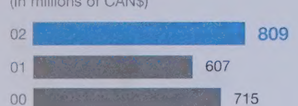
Selling, general and administrative (SG&A) expenses increased by $68 million in 2002 or by 27% compared to 2001. This increase was mainly due to the inclusion of SG&A expenses of the Acquired Mills and to our share of Norampac's recent acquisitions, partially offset by the impact of our cost reduction initiatives. The 2001 SG&A expenses had been reduced by $14 million related to the cashing in of certain insurance policies.

As a result of the factors mentioned above, earnings before financing expenses, income taxes and amortization (EBITDA) for 2002 amounted to $809 million (or $845 million before Closure Costs) compared to $607 million in 2001. Operating profit for 2002 amounted to $384 million (or $447 million before Closure Costs) compared to $313 million in 2001, as presented below:

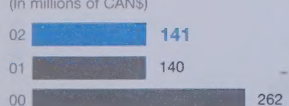
Variance analysis 2002 vs 2001 (In millions of Canadian dollars)

2001 operating profit	**313**
Quality and profitability improvement programs	116
Acquired Mills - incremental 7 months	96
Impact of the U.S. dollar	34
Net impact of softwood lumber duties	9
Lower average transaction prices	(121)
2002 operating profit (before Closure Costs)	**447**

EBITDA
(In millions of CAN$)



Net earnings[1]
(In millions of CAN$)



Net earnings of $141 million

Net earnings in 2002 amounted to $141 million ($0.62 per common share) compared to net earnings of $140 million ($0.72 per common share) in 2001. Excluding Closure Costs, net earnings in 2002 amounted to $183 million ($0.80 per common share). The 2001 net earnings have been restated to include the recognition of unrealized foreign exchange losses of $12 million net of income taxes ($0.06 per common share) in accordance with amended accounting recommendations. Also included in the 2001 net earnings was an income tax benefit of $39 million ($0.20 per common share) related to a reduction in enacted income tax rates and a revaluation of future income tax assets.

In 2002, we delivered a 6% return on average common shareholders' equity (ROE) compared to 7% in 2001. Excluding Closure Costs, ROE in 2002 was maintained at 7%, despite a difficult economic environment as evidenced by the 4% decrease in our selling price index.

Free cash flow

We generated free cash flow (cash flows from operating activities less net additions to property, plant and equipment) of $454 million in 2002 compared to $447 million in 2001. When excluding net additional cash proceeds received from the sales of receivables, free cash flow amounted to $428 million in 2002 compared to $269 million in 2001. Free cash flow generated in 2002 was applied primarily to debt reduction.

[1] Figures have been restated following the application of amended accounting recommendations that are described in "Accounting Changes".

Papers

Selected information (In millions of Canadian dollars, unless otherwise noted)

	Years ended December 31	
	2002	**2001**
Net sales	**3,234**	2,237
Operating profit	**301**	246
Operating profit excluding Paper Closure Costs	**346**	246
Shipments:		
Paper ('000 ST)	**2,613**	1,828
Pulp ('000 ADST)	**789**	505
Paper shipments product offering (%):		
Copy and offset grades	**55**	48
Uncoated commercial printing & publication and premium imaging grades	**18**	19
Coated commercial printing & publication grades	**13**	20
Technical & specialty grades	**14**	13
Total	**100**	100
Benchmark nominal prices[1]:		
Copy 20 lb sheets (US$/ton)	**776**	815
Offset 50 lb rolls (US$/ton)	**692**	719
Coated publication, no. 3, 60 lb rolls (US$/ton)	**767**	853
Pulp NBSK (US$/tonne)	**491**	558

[1] Source: Pulp & Paper Week

Sales and operating profit

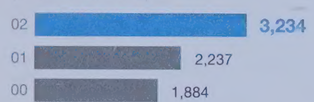
Net sales in our Papers business amounted to $3,234 million, an increase of $997 million or 45% over 2001. This increase was primarily due to the inclusion of net sales of the Acquired Mills for twelve months in 2002 compared to five months in 2001 and to the favorable effect of a stronger U.S. dollar. This increase was partially offset by the decline in transaction prices for both paper and pulp as well as to lower pulp shipments from our Canadian mills.

Operating profit in our Papers business amounted to $301 million in 2002, a 22% increase over $246 million in 2001. Excluding the $45 million provision related to Paper Closure Costs, operating profit amounted to $346 million in 2002, a $100 million or 41% increase over 2001. This increase was primarily due to the inclusion of operating profit of the Acquired Mills for twelve months in 2002 compared to five months in 2001 and to the realization of Acquisition-related synergies. The Papers business also benefited from a $16 million investment tax credit related to research and development expenditures of prior years, the favorable effect of a stronger U.S. dollar, as well as lower purchased fiber and energy costs. These positive factors were partially offset by the decline in transaction prices for both paper and pulp as well as to lower pulp shipments from our Canadian mills.

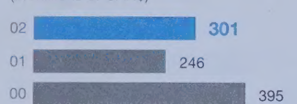
Pricing environment

The decline in our average transaction prices in 2002 as compared to 2001 in our Papers segment was lower than that of the benchmark nominal prices, which represent average market prices, for similar products.

Net sales
(In millions of CAN$)

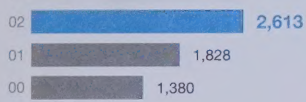


Operating profit
(In millions of CAN$)



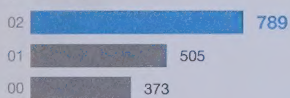
Papers (continued)

Papers shipments[1]
('000 ST)



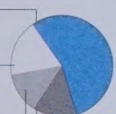
[1] Figures exclude shipments by our Paper Merchants.

Pulp shipments
('000 ADST)



Shipments product offering

Copy and offset grades 55 %
Uncoated commercial printing and publication and premium imaging grades 18 %
Coated commercial printing and publication grades 13 %
Technical & specialty grades 14%



2002

Despite the implementation of price increases for copy and offset grades during the year, our 2002 average transaction prices for 20 lb copy sheets (business papers) and 50 lb offset rolls (uncoated commercial printing & publication papers) decreased by an average of US$18/ton compared to 2001.

Our weighted average transaction price for our coated commercial printing & publication papers in 2002 decreased by US$34/ton compared to 2001, reflecting the impact of imports on the coated market.

Despite successive US$10/tonne price increases for both hardwood and softwood pulp implemented in each of May, June and July 2002, pulp transaction prices declined during the latter part of the year. Our 2002 average Northern Bleached Softwood Kraft (NBSK) and Northern Bleached Hardwood Kraft (NBHK) pulp transaction prices decreased by an average of US$23/tonne compared to 2001. Effective February 1, 2003, a US$20/tonne price increase has been announced for both softwood and hardwood pulp with a further US$40/tonne price increase for both products effective March 1, 2003.

Production efficiency

During 2002, we substantially completed our efforts to integrate the Acquired Mills in our Papers business. By year-end, the majority of our new employees (96% of employees of the Acquired Mills) had participated in interactive training sessions related to Domtar's management philosophy and corporate values. In addition, approximately 11% of our new employees of the Acquired Mills have participated in Kaïzen continuous improvement workshops.

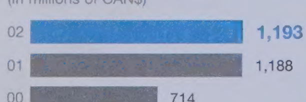
In 2002, we took market-related downtime, curtailing production by 55,000 tons of paper, representing approximately 2% of our 2002 production capacity. This, as well as the impact of the above-mentioned closures of two paper machines in St. Catharines and one in Nekoosa which permanently curtailed 80,000 tons of paper production, reflects our commitment to adjust production to customers' needs.

From December 20, 2002 to January 19, 2003, we halted production at the Lebel-sur-Quévillon, Québec, pulp mill due to declining prices for softwood pulp. Production curtailment of pulp totaled 52,000 tons for 2002.

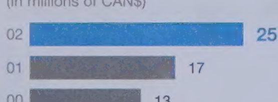
During 2002, we continued to focus our efforts on reducing our costs and on achieving synergies related to the Acquisition. As at December 31, 2002, our synergies had reached an annualized run rate of US$80 million, surpassing our US$65 million objective.

Paper Merchants

Net sales
(In millions of CAN$)



Operating profit
(In millions of CAN$)



Selected information (In millions of Canadian dollars)

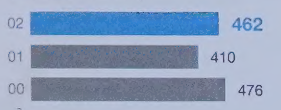
	Years ended December 31	
	2002	2001
Net sales	**1,193**	1,188
Operating profit	**25**	17

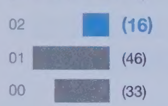
Sales and operating profit

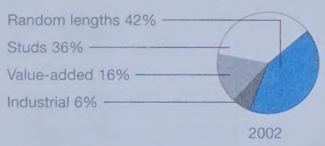
Despite a difficult first half of 2002, particularly in the United States, net sales in the Paper Merchants business amounted to $1,193 million, an increase of $5 million over 2001. This increase was due to continued volume growth and market share gains realized throughout 2002, partially offset by lower average selling prices compared to 2001.

Operating profit in the Paper Merchants business of $25 million generated an operating margin of 2.1% in 2002 compared to $17 million operating profit or 1.4% operating margin in 2001. In addition to the impact of higher volume, operating profit increased due to favorable sales mix and lower operating costs resulting from the consolidation of our American and Canadian merchant businesses into one group.

Wood







Selected information (In millions of Canadian dollars, unless otherwise noted) Years ended December 31	2002	2001
Net sales	**462**	410
Operating loss	**(16)**	(46)
Operating profit (loss) excluding Wood Closure Costs	**2**	(46)
Operating profit (loss) excluding Wood Closure Costs and softwood lumber duties	**13**	(26)
Shipments (millions of FBM)	**1,037**	982
Shipments product offering (%):		
Random lengths	**42**	44
Studs	**36**	36
Value-added	**16**	14
Industrial	**6**	6
Total	**100**	100
Benchmark nominal prices[1]:		
Lumber 2x4 R/L no. 1 & no. 2 (US$/MFBM)	**331**	346
Lumber 2x4x8 stud (US$/MFBM)	**334**	345

[1] Source: Random Lengths.

Sales and operating profit

Net sales in our Wood business amounted to $462 million, an increase of $52 million or 13% over 2001. Excluding the net impact of duties on exports of softwood lumber to the United States, net sales amounted to $473 million in 2002 compared to $430 million in 2001. The increase in net sales was primarily due to higher shipments, a better sales mix stemming from upgrades to equipment and the favorable effect of a stronger U.S. dollar.

Operating loss amounted to $16 million in 2002 compared to an operating loss of $46 million in 2001. Excluding the $18 million provision related to Wood Closure Costs as well as the $11 million net impact of duties on exports of softwood lumber to the United States ($31 million cash deposits made in 2002 less the reversal of $20 million provision recorded in 2001), our Wood business reported a $13 million operating profit in 2002 compared to an operating loss of $26 million in 2001 when compared on the same basis. This $39 million improvement was primarily due to cost reduction initiatives, a better sales mix stemming from equipment upgrades and the favorable effect of a stronger U.S. dollar.

Pricing environment

In 2002, the variation in our average transaction prices was consistent with that of the market. Average benchmark nominal prices in 2002 for Great Lakes 2x4 studs were lower by US$11/MFBM and average benchmark nominal prices for random lengths were lower by US$15/MFBM compared to 2001.

Production efficiency

In June 2002, a decision was taken to halt the Ste-Marie and Ste-Aurélie sawmill operations for an undetermined period of time due to the Canada-U.S. softwood lumber dispute. In July 2002, the Grand-Remous sawmill ceased operations due to a dispute between the Barriere Lake First Nation and the governments of Québec and Canada. Although the dispute was settled, the sawmill has not been restarted because of market conditions.

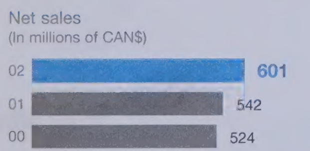
Wood (continued)

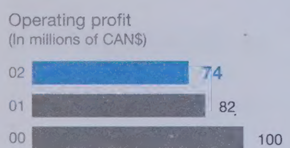
In September 2002, we announced the combination of our timber and lumber operations. This initiative was considered necessary to further increase productivity, reduce costs and improve customer service in difficult market conditions.

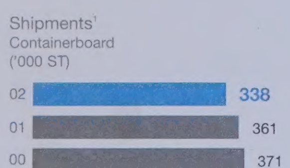
In November 2002, we announced that the usual two-week holiday shutdowns at the sawmills would be extended for an additional two weeks at the Lebel-sur-Quévillon, Matagami and Malartic sawmills. These decisions were taken to avoid producing for inventory in a declining product price environment. These sawmills resumed operations on January 20, 2003.

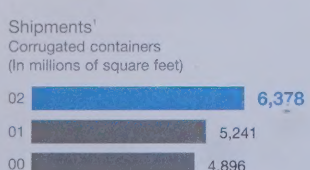
In the Wood business, we continued to pursue sawmill modernization aimed at improving profitability. Productivity improvements were experienced at the Malartic, Matagami, White River and Nairn sawmills. We will continue to examine opportunities to further improve the profitability of the Wood business through additional cost reductions and strategic alternatives.

Packaging









Years ended December 31

Selected information (In millions of Canadian dollars, unless otherwise noted)	2002	2001
Net sales	**601**	542
Operating profit	**74**	82
Shipments[1]:		
Containerboard ('000 ST)	**338**	361
Corrugated containers (millions of square feet)	**6,378**	5,241
Benchmark nominal prices[2]:		
Linerboard 42 lb (US$/ton)	**427**	445

Sales and operating profit

Our 50% share of Norampac's net sales amounted to $601 million, an increase of $59 million or 11% over 2001. This was mainly due to higher volumes for corrugated products, primarily related to Norampac's recent acquisitions, partially offset by lower net selling prices for containerboard and corrugated products.

Our 50% share of Norampac's operating profit amounted to $74 million, a decrease of $8 million or 10% from the $82 million operating profit reported in 2001. This decrease was mainly attributable to a reduction of the net selling price of containerboard and corrugated products, partially offset by higher volumes of corrugated containers resulting from Norampac's recent acquisitions.

Pricing environment

Despite the implementation of price increases of approximately US$25/ton for both medium and linerboard in July 2002, Norampac's average kraft linerboard transaction prices decreased by US$18/ton in 2002 compared to 2001, consistent with the decrease in the benchmark nominal prices. Prices for corrugated boxes in 2002 benefited from a 9% price increase implemented in July, resulting in overall prices remaining relatively stable compared to 2001.

Production efficiency

During 2002, Norampac took market-related downtime at its containerboard mills for a total of 103,400 tons, representing approximately 7% of its North American production capacity. This reflects Norampac's commitment to adjust production to customers' needs.

[1] Represents 50% of Norampac's trade shipments.
[2] Source: Pulp & Paper Week.

Financing expenses and income taxes

Financing expenses

In 2002, financing expenses amounted to $192 million, a $25 million increase over 2001. This increase resulted from the inclusion of interest on indebtedness related to the Acquisition for twelve months in 2002 compared to five months in 2001, partially offset by the impact of lower interest rates and interest rate swaps. Financing expenses in 2001, totaling $167 million, included unrealized foreign exchange losses of $15 million related to the valuation of our U.S. dollar denominated debt, in accordance with changes in accounting policies.

Income taxes

Our income tax expense for 2002 was $56 million, reflecting an effective tax rate of 28.4%, compared to income tax expense of $11 million, or an effective tax rate of 7.3% in the prior period. In 2001, a reduction in statutory enacted income tax rates and a revaluation of future income tax assets had resulted in a $39 million reduction in income tax expense. Excluding this reduction, the 2001 effective tax rate was 33.1%. The reduction in the effective tax rate reflects tax planning initiatives and a different tax jurisdiction mix.

Balance sheet

Our total consolidated assets were $6,847 million as at December 31, 2002 compared to $7,055 million as at December 31, 2001. Receivables amounted to $304 million as at December 31, 2002 compared to $300 million as at December 31, 2001. Total inventories as at December 31, 2002 were $736 million, a reduction of $43 million when compared to $779 million as at December 31, 2001. This decrease reflects the impact of inventory reduction programs as well as mill closures. Property, plant and equipment as at December 31, 2002 totaled $5,387 million compared to $5,612 million as at December 31, 2001. This $225 million decrease was mainly due to a lower level of capital expenditures as compared to amortization expense during the year.

Trade and other payables were $749 million as at December 31, 2002 compared to $708 million as at December 31, 2001, an increase of $41 million. This increase was mainly due to higher trade accounts payables and provisions for Closure Costs, partially offset by the $20 million reversal of provision for duties on exports of softwood lumber to the United States. Long-term debt (including the portion due within one year) as at December 31, 2002 decreased to $2,514 million compared to $2,921 million as at December 31, 2001, mainly reflecting repayments on our term loan.

Liquidity and capital resources

Selected information (In millions of Canadian dollars)	Years ended December 31 2002	2001
Cash flows provided from operating activities before changes in working capital and other items	**632**	436
Changes in working capital and other items	**45**	291
Cash flows provided from operating activities	**677**	727
Net additions to property, plant and equipment	**(223)**	(280)
Free cash flow	**454**	447
Net debt-to-total-capitalization ratio (in %)	**49**	55

Our principal liquidity requirements are for working capital, capital expenditures, and principal and interest payments on our debt. We expect to fund our liquidity needs primarily with internally generated funds from our operations and, to the extent necessary, through borrowings under our revolving credit facility. We also have the ability to fund liquidity requirements through the issuance of debt and/or equity.

Cash flows provided from operating activities
(In millions of CAN$)

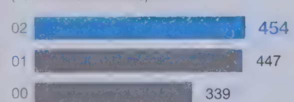
Operating activities

Cash flows provided from operating activities in 2002 amounted to $677 million, a $50 million decrease over 2001. Net additional cash proceeds from the sales of receivables were $26 million in 2002 compared to $178 million in 2001. Excluding net additional cash proceeds from the sales of receivables, cash flows provided from operating activities amounted to $651 million in 2002 compared to $549 million in 2001. This $102 million increase in cash flows was mainly due to an increase in EBITDA.

Liquidity and capital resources (continued)

Net additions to property, plant and equipment
(In millions of CAN$)

Free cash flow
(In millions of CAN$)



Net debt-to-total capitalization ratio
(In %)

Investing activities

Cash flows used for investing activities in 2002 amounted to $249 million compared to $2,901 million in 2001. Investing activities in 2001 included $2,569 million related to the Acquisition.

Net additions to property, plant and equipment for the year ended December 31, 2002 amounted to $223 million, a $57 million decrease over 2001. We intend to limit our annual capital expenditures over a business cycle to 75% of amortization, or approximately $290 million in 2003, including approximately $140 million for capital expenditures relating to the long-term sustainability of our equipment.

Free cash flow (cash flows from operating activities less net additions to property, plant and equipment) for 2002 totaled $454 million compared to $447 million in 2001. When excluding net additional proceeds received from the sales of receivables, free cash flow amounted to $428 million in 2002 compared to $269 million in 2001. The year-over-year increase in free cash flow reflects the increase in EBITDA, as well as our reduced level of capital spending. Free cash flow generated in 2002 was applied primarily to debt reduction.

Financing activities

Cash flows used for financing activities in 2002 amounted to $426 million compared to cash flows generated of $2,181 million in 2001. In 2002, repayment of long-term debt related mainly to the bank term loan. In 2001, issuances and repayments of long-term debt related principally to the financing of the Acquisition.

As at December 31, 2002, our net debt-to-total-capitalization ratio was 49%, a decrease of 6% over the 55% as at December 31, 2001. Net indebtedness, including $191 million representing our 50% share of the net indebtedness of Norampac, was $2,496 million as at December 31, 2002. This compares to $2,930 million at the end of 2001, including $192 million for our 50% share of the net indebtedness of Norampac. We intend to further reduce our net debt-to-total-capitalization ratio to 45% or below by December 31, 2003.

As at December 31, 2002, the balance of the US$1 billion bank term loan, initially entered into to finance the Acquisition, was US$480 million ($758 million), a decrease of US$250 million ($392 million) from December 31, 2001. The term loan bears interest based on the U.S. dollar LIBOR rate or the U.S. prime rate, plus a margin that varies with Domtar's credit rating.

As at December 31, 2002, of the US$500 million revolving credit facility, $8 million was drawn in the form of overdraft and included in "Bank Indebtedness" and $9 million (US$6 million) of letters of credit were outstanding, resulting in US$489 million ($773 million) of availability under this facility. As at December 31, 2001, $15 million was drawn in the form of overdraft and $11 million (US$7 million) letters of credit were outstanding. Borrowings under this revolving credit facility bear interest at a rate based on the Canadian dollar bankers' acceptance or the U.S. dollar LIBOR rate or the prime rate, plus a margin that varies with Domtar's credit rating. This bank facility also requires commitment fees in accordance with standard banking practices.

Our borrowing agreements contain restrictive covenants. In particular, our US$500 million unsecured revolving credit facility contains covenants that require compliance with certain financial ratios on a quarterly basis. Also, the indentures related to the 10% and 10.85% debentures limit the amount of dividends that we may pay, the amount of shares that we may repurchase for cancellation and the amount of new debt we may incur.

In 2002, common shares amounting to $21 million were issued pursuant to our stock option and share purchase plans. In 2001, we issued common shares related to the financing of the Acquisition for a net consideration of $499 million. During 2002, we did not purchase for cancellation any of our common shares. During 2001, we purchased 283,400 common shares under a Normal Course Issuer Bid.

As at February 28, 2003, we had 227,924,367 common shares, 69,576 Series A Preferred Shares and 1,710,000 Series B Preferred Shares, which were issued and outstanding.

Off balance sheet arrangements

In the normal course of business, we finance certain of our activities off balance sheet through leases and securitizations.

Leases

On an ongoing basis, we enter into operating leases for plant and equipment. Minimum future rental payments under these operating leases, determined as at December 31, 2002, amounted to $152 million, of which $37 million related to our proportionate share of Norampac.

Securitizations

We sell a portion of our Canadian and U.S. accounts receivables through securitization programs. As at December 31, 2002, the value of securitized receivables amounted to $264 million compared to $238 million as at December 31, 2001. We expect to continue to sell receivables on an ongoing basis, given the attractive discount rates. Should we decide to discontinue these programs, our working capital and our bank debt requirements would increase. Such sales of receivables are contingent upon Domtar retaining specified credit ratings.

Contractual obligations and commercial commitments

In the normal course of business, we enter into certain contractual obligations and commercial commitments. The following tables provide our obligations and commitments as at December 31, 2002:

Contractual obligations (In millions of Canadian dollars)

Contract type	2003	2004	2005	2006	2007	2008 & thereafter	Total
Debentures and notes	68	50	50	849	1	1,478	2,496
Other	2	1	1	1	1	12	18
Long-term debt	70	51	51	850	2	1,490	2,514
Operating leases	39	33	21	17	11	31	152
Total obligations	109	84	72	867	13	1,521	2,666

Commercial commitments (In millions of Canadian dollars)

Commitment type	2003	2004	2005	2006	2007	2008 & thereafter	Total
Letters of credit	8	1	–	–	–	–	9
Other commercial commitments*	72	48	37	35	28	45	265
Total commitments	80	49	37	35	28	45	274

*Includes commitments to purchase roundwood, wood chips, gas, electricity, steam and certain chemicals.

For 2003 and the foreseeable future, we expect cash flows from operations and from our various sources of financing to be sufficient to meet our contractual obligations and commercial commitments.

2001 compared to 2000[1]

Net sales in 2001 totaled $4,377 million, up $779 million or 22% from net sales of $3,598 million in 2000. This increase was mainly due to the inclusion of net sales of the Acquired Mills for five months in 2001, the inclusion of net sales of Ris Paper for twelve months in 2001 compared to five months in 2000, as well as the inclusion of our share of net sales of Norampac's 2001 acquisitions. Net sales were also favorably impacted by a stronger U.S. dollar. Excluding the impact of these acquisitions, net sales would have decreased by $303 million over 2000, mainly due to lower transaction prices for all our products, except for lumber, and lower shipments for all our businesses resulting from production curtailments taken in order to adjust to customers' needs.

[1] Figures have been restated following the application of amended accounting recommendations that are described in "Accounting Changes".

2001 compared to 2000[1] (continued)

Cost of sales increased by $811 million or 30% in 2001 compared to 2000 due mainly to the inclusion of cost of sales of the Acquired Mills, Ris Paper, and our share of cost of sales of Norampac's 2001 acquisitions, as well as a $30 million increase in energy costs and increases in certain other production costs. The impact of these increases was partially offset by lower shipments for all of our businesses, excluding the impact of the acquisitions mentioned above, and lower purchased fiber costs.

SG&A expenses increased by $76 million or 42% in 2001 compared to 2000. This increase was mainly due to the inclusion of SG&A expenses of Ris Paper, the Acquired Mills and our share of Norampac's 2001 acquisitions.

As a result of the factors mentioned above, EBITDA amounted to $607 million in 2001 compared to $715 million in 2000, and operating profit in 2001 amounted to $313 million compared to $476 million in 2000.

Net earnings amounted to $140 million ($0.72 per common share) in 2001 compared to $262 million ($1.42 per common share) in 2000. The 2001 net earnings benefited from the cashing in of certain insurance policies as well as a reduction in statutory enacted income tax rates, representing $9 million ($0.05 per common share) and $39 million ($0.20 per common share), respectively. For the year ended December 31, 2000, a reduction in statutory enacted income tax rates and a revaluation of future income tax assets resulted in a reduction in income tax expense of $30 million ($0.16 per common share).

In 2001, we delivered a 7% ROE, and this in a difficult economic context, as evidenced by the 5% decrease in our selling price index, compared to an ROE of 15% in 2000.

We generated free cash flow of $447 million in 2001 compared to $339 million in 2000. Excluding net additional proceeds received from the sales of receivables, free cash flow in 2001 amounted to $269 million, in a difficult market environment, compared to $279 million in 2000.

As at December 31, 2001, our net debt-to-total-capitalization ratio was 55% compared to a ratio of 37% at December 31, 2000 and approximately 65% at the date of the Acquisition. Net indebtedness, including $192 million for our 50% share of the net indebtedness of Norampac, was $2,930 million at December 31, 2001 compared to $1,809 million at the end of 2000, including $158 million for our 50% share of the net indebtedness of Norampac. The value of securitized receivables amounted to $238 million as at December 31, 2001 compared to $60 million as at December 31, 2000.

Accounting changes

Stock-based compensation and other stock-based payments

Effective January 1, 2002, we have adopted the new CICA recommendations relating to the accounting for stock-based compensation and other stock-based payments. The recommendations require the use of a fair-value based approach of accounting for stock-based payments to non-employees. The recommendations do not require the use of the fair value method when accounting for stock-based awards to employees, except for stock-based compensation that meets specific criteria. However, we have chosen to record an expense for the stock options granted to our employees using the fair value method.

In accordance with the transitional provisions of the new accounting recommendations, we have adopted the new recommendations for awards granted after January 1, 2002. The effect of the adoption of the recommendations has been reflected as a charge of $4 million ($0.02 per common share) for the year ended December 31, 2002.

Foreign currency translation

Effective January 1, 2002, we have adopted the amended CICA recommendations relating to the accounting for foreign currency translation. These recommendations eliminate the requirement to defer and amortize unrealized exchange gains and losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of the fiscal year following the current reporting period.

[1] Figures have been restated following the application of amended accounting recommendations that are described in "Accounting Changes".

In accordance with the transitional provisions of the amended accounting recommendations, we have applied these recommendations retroactively with restatement of prior years. The cumulative effect of the adoption of the recommendations has been reflected as a charge of $14 million ($9 million net of income taxes) to opening retained earnings for the year ended December 31, 2000. Financing expenses for the years ended December 31, 2001 and 2000 were increased by $15 million ($12 million net of income taxes, or $0.06 per common share) and $18 million ($13 million net of income taxes, or $0.07 per common share), respectively, to reflect the application of these recommendations.

The Corporation has designated all of its U.S. dollar denominated long-term debt as a hedge of its net investment in self-sustaining foreign subsidiaries and, to the extent necessary, as a foreign currency hedge of its future U.S. dollar revenue streams. For such debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account. For the remaining U.S. dollar denominated long-term debt designated as a hedge of future U.S. dollar revenue streams, exchange gains and losses are deferred and recognized when the designated revenue is earned or such time as the hedge ceases to be effective. Consequently, there was no impact on the results of the Corporation for 2002.

Norampac has designated a portion of its U.S. dollar denominated long-term debt as a hedge of its net investment in self-sustaining foreign subsidiaries. For such debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account. For the remaining U.S. dollar denominated long-term debt the exchange gains and losses are included in "Financing expenses".

Goodwill and intangible assets

Effective January 1, 2002, we ceased the amortization of goodwill with the adoption of the new CICA recommendations relating to the accounting for goodwill and other intangible assets. These recommendations require goodwill to no longer be amortized and be tested annually for impairment. Intangible assets with a finite life will continue to be amortized over their useful life.

In accordance with the transitional provisions of the new accounting recommendations, we have performed the impairment test of our goodwill and have determined that no write down for impairment was necessary. We have also reclassified, to timber and timber lands, an amount of $12 million recorded in goodwill in prior years. This amount, now presented under "Property, plant and equipment", meets the criteria allowing its reclassification from goodwill. For the years ended December 31, 2001 and 2000, goodwill amortization expense was $4 million ($0.02 per common share) and $2 million ($0.01 per common share), respectively.

Disclosure of guarantees

In February 2003, the CICA issued an accounting guideline on the financial statements disclosures to be made by a guarantor relative to its obligations under guarantees. Effective for the fiscal year beginning January 1, 2003, the accounting guideline requires the disclosure of the nature of the guarantee, approximate term of the guarantee, how it arose, the events or circumstances that would trigger performance under the guarantee, the maximum potential amount of future payments, the current carrying amount of the liability, the nature of any recourse provision and any assets held as collateral. In accordance with the transitional provisions of this accounting guideline, we adopted the recommendations for the year ended December 31, 2002.

Impact of accounting pronouncements not yet implemented

Impairment of long-lived assets

In December 2002, the CICA issued new recommendations relating to the impairment of long-lived assets, such as property, plant and equipment. These recommendations provide accounting guidance for the determination of a long-lived asset impairment as well as recognition, measurement and disclosure of the impairment. These recommendations are effective for fiscal years beginning on or after April 1, 2003. As the impairment test is based on the recoverability of any group of assets from which cash flows are identifiable, we are currently assessing the impact that this recommendation will have on our results of operations and financial position.

Impact of accounting pronouncements not yet implemented (continued)

Disposal of long-lived assets and discontinued operations

In December 2002, the CICA issued new recommendations relating to the disposal of long-lived assets, such as property, plant and equipment, and discontinued operations. These recommendations provide accounting guidance for disposal of long-lived assets and presentation and disclosure for discontinued operations. These recommendations are effective for disposal activities initiated on or after May 1, 2003.

Hedging relationships

In November 2002, the CICA amended accounting guideline relating to hedging relationships. This accounting guideline must be applied to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. This accounting guideline addresses the identification, designation, documentation and effectiveness of the hedging relationships for the purpose of applying hedge accounting. In addition, it deals with the discontinuance of hedge accounting and establishes conditions for applying hedge accounting. Under this guideline, documentation of the information related to hedging relationships is required and the effectiveness of the hedges must be demonstrated and documented. We do not expect these recommendations to have an initial impact on our financial statements upon adoption.

Critical accounting policies

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect our results of operations and financial position. On a regular basis, management reviews its estimates, including those related to environmental matters, amortization methods and useful lives, impairment of assets, pension and other employee future benefit plans, and income taxes based upon currently available information. Actual results could differ from those estimates.

The following critical accounting policies reflect matters that contain a significant level of management estimates about future events, reflect the most complex and subjective judgments, and are subject to a fair degree of measurement uncertainty. To the best of our knowledge and belief, based on the information currently available, management does not believe that the variation in the estimates reflected in the consolidated financial statements could have a material adverse effect on our results of operations or financial condition.

Environmental matters

Environmental expenditures for effluent treatment, air emission, landfill operation and closure, asbestos containment and removal, bark pile management, and sylviculture activities (together referred to as environmental matters) are expensed or capitalized depending upon their future economic benefit. In the normal course of business, we incur certain operating costs for environmental matters which are expensed as incurred. Expenditures for property, plant and equipment that prevent future environmental contamination are capitalized and amortized on a straight-line basis over a period of 10 to 30 years. Provisions for environmental matters are not discounted and are recorded when remediation efforts are likely and can be reasonably determined. As at December 31, 2002, we had a provision of $75 million for environmental matters.

We continue to take remedial action under our Care and Control Program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, the development of technological applications and the allocation of liability among potentially responsible parties.

While we believe that we have determined the costs for environmental matters likely to be incurred in the next several years, based on known information, our ongoing efforts to identify potential environmental concerns that may be associated with our properties may lead to future environmental investigations. These efforts may result in the determination of additional environmental costs and liabilities which cannot be reasonably estimated at this time.

Impairment of assets

At least annually, we assess whether there has been a permanent impairment in the value of assets. For assets other than goodwill, this is accomplished by determining whether projected undiscounted future cash flows from operations exceed the net carrying amount of the asset as of the assessment date. Goodwill is subject to an annual impairment test which is accomplished by comparing the fair value of the reporting units with their respective carrying amount. Estimates of future cash flows and fair values require judgment and may change.

Pension and other employee future benefit plans

We account for pension and other employee future benefits in accordance with CICA recommendations. As such, assumptions are made regarding the valuation of benefit obligations and performance of plan assets. Deferred recognition of differences between actual results and those assumed is a guiding principle of these recommendations. This approach allows for a gradual recognition of changes in benefit obligations and plan performance over the expected average remaining service life of the active employee group covered by the plans.

Pension and other employee future benefits assumptions include the discount rate, the expected long-term rate of return on plan assets, the rate of compensation increase, health care cost trend rates, mortality rates, employee early retirements and terminations or disabilities. Changes in these assumptions result in actuarial gains or losses which, in accordance with CICA recommendations, we have elected to amortize over the expected average remaining service life of the active employee group covered by the plans only to the extent that the unrecognized net actuarial gains and losses are in excess of 10% of the greater of the accrued benefit obligation and the market-related value of plan assets as at the beginning of the year. The future effect on our results of operations is dependent on economic conditions, employee demographics, mortality rates and investment performance.

The following table provides a sensitivity analysis of the key weighted average economic assumptions used in measuring the accrued pension benefit obligation, the accrued other employee future benefits obligation and related net periodic benefit cost for 2002. The sensitivity analysis should be used with caution as it is hypothetical and changes in each key assumption may not be linear. The sensitivities in each key variable have been calculated independently of each other.

Sensitivity analysis

Pension and other employee future benefits

(In millions of Canadian dollars)

		Pension		Other employee future benefits	
		Accrued benefit obligation	Net periodic benefit cost	Accrued benefit obligation	Net periodic benefit cost
Expected rate of return on assets					
Impact of:	1% increase	–	(10)	N/A	N/A
	1% decrease	–	10	N/A	N/A
Discount rate					
Impact of:	1% increase	(119)	(7)	(12)	(1)
	1% decrease	121	10	14	1
Assumed overall health care cost trend					
Impact of:	1% increase	N/A	N/A	8	1
	1% decrease	N/A	N/A	(6)	(1)

Risks and uncertainties

Product prices

Our financial performance is sensitive to the selling prices of our products. The markets for most paper, pulp, lumber and packaging products are cyclical and are influenced by a variety of factors beyond our control. These factors include periods of excess product supply due to industry capacity additions, periods of decreased demand due to weak general economic activity in North America or international markets, inventory de-stocking by customers and fluctuations in currency exchange rates. During periods of low prices, we have experienced in the past, and could experience in the future, reduced revenues and margins, resulting in substantial declines in profitability and sometimes net losses. (See "Sensitivity analysis".)

Operational

The activities conducted by our businesses are subject to a number of operational risks including competition, performance of key suppliers and distributors, renewal of collective agreements, regulatory risks, successful integration of new acquisitions, retention of key personnel and reliability of information systems. In addition, operating costs for our businesses can be affected by changes in energy and other raw material prices as a result of changing economic or political conditions or due to particular supply and demand considerations.

Risks and uncertainties (continued)

Foreign exchange

Our revenues for many of our products are affected by fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar. The prices for many of our products, including those we sell in Canada, are generally driven by U.S. prices of similar products. We generate approximately US$1 billion of U.S. dollar denominated sales annually from our Canadian operations. As a result, any decrease in the value of the U.S. dollar relative to the Canadian dollar reduces the amount of Canadian dollar revenues we realize on sales. Exchange rate fluctuations are beyond our control and the U.S. dollar may depreciate against the Canadian dollar in the future, which would result in lower revenues and margins. In order to reduce the potential negative effect of a weakening U.S. dollar, we may hedge the value of a portion of our future U.S. dollar net cash inflows for periods of up to three years. Our hedging arrangements as at December 31, 2002, included forward contracts totaling US$132 million maturing in 2003 that commit us to selling U.S. dollars at an average exchange rate of 1.50, as well as currency options purchased totaling US$144 million that give us the option to sell U.S. dollars at 1.43 in 2003. In addition, we have currency options sold totaling US$144 million maturing in 2003, which limit us from benefiting from a U.S. dollar trading above an average exchange rate of 1.51.

Environmental regulations

We are subject to United States and Canadian environmental regulations relating to, among other matters, effluent and air emissions, timber cutting, waste management, groundwater quality, plant and wildlife protection, landfill sites and employee health and safety. These regulations require us to obtain and comply with the conditions of permits and authorizations from the appropriate governmental authorities. Regulatory authorities exercise considerable discretion in whether or not to issue permits and the timing of permit issuances. If we fail to comply with applicable requirements, our operations at the affected facilities could be interrupted and we could be required to incur significant additional expenditures which could negatively impact our financial results and financial condition. In addition, changes in environmental laws and regulations or their application could require us to make further significant expenditures.

Failure to comply with applicable environmental laws, regulations or permit requirements may result in fines or penalties or enforcement actions by the regulators, including regulatory or judicial orders enjoining or curtailing operations or requiring corrective measures, installation of environmental control equipment or remedial actions, any of which could entail significant expenditures.

The Pulp and Paper industry in the United States is subject to the Cluster Rules that further regulate effluent and air emissions. We presently comply with all current regulations and we anticipate spending approximately $43 million to meet the further Cluster Rules requirements by 2005 and 2006.

Lumber export duties

Our sales of Wood represent approximately 8% of our consolidated net sales in 2002 and we export approximately 57% of our softwood lumber products to the United States.

The United States Department of Commerce announced that it had assessed the Canadian softwood lumber industry with final aggregate countervailing and antidumping duties at an average rate of 27.22%. Since May 22, 2002, based upon a final decision of the United States International Trade Commission, we have made the required cash deposits on our exports of softwood lumber to the United States. The Canadian government has challenged the duties with the World Trade Organization and under the North American Free Trade Agreement.

We are currently experiencing, and may continue to experience, reduced revenues and margins in our Wood business as a result of countervailing and antidumping duty applications or as a result of any new arrangement between the United States and Canada.

Sensitivity analysis

Our operating profit, net earnings and earnings per share can be impacted by the following sensitivities:

(In millions of Canadian dollars, except per share amounts)

	Annual impact on[1]		
	Operating profit	Net earnings	Earnings per share
Each US$10/unit change in price of:[2]			
Papers			
Copy and offset grades	21	14	0.06
Uncoated commercial printing & publication and premium imaging grades	9	6	0.03
Coated commercial printing & publication grades	5	3	0.01
Technical & specialty grades	6	4	0.02
Pulp – net position	8	5	0.02
Wood			
Lumber	14	9	0.04
Packaging			
Containerboard	5	3	0.01
Foreign exchange			
CAN $0.01 change in relative value to the U.S. dollar			
After hedging[3]	8	5	0.02
Before hedging	10	7	0.03
Interest rate			
1% change in interest rates on our floating rate debt	N/A	5	0.02
Energy[4]			
Natural gas			
US$0.25/MMBtu change in price	6	4	0.02
Crude oil			
US$1/barrel change in price	2	1	0.01

[1] Based on an exchange rate of 1.515 and a marginal tax rate of 35%.
[2] Based on budgeted 2003 capacity (in tons, tonnes or MFBM).
[3] Based on currency hedging portfolio for the period of January 1 to December 31, 2003.
[4] Based on budgeted 2003 consumption levels. The allocation between energy sources may vary during the year in order to take advantage of market conditions.

Sensitivity analysis (continued)

Benchmark nominal prices[1]	1995	1996	1997	1998	1999	2000	2001	2002	Trend[2]
Papers:									
Copy 20 lb sheets (US$/ton)	1,123	848	769	780	778	877	815	**776**	831
Offset 50 lb rolls (US$/ton)	983	736	756	666	659	757	719	**692**	751
Coated publication, no. 3, 60 lb rolls (US$/ton)	1,200	943	941	909	851	948	853	**767**	984
Pulp NBSK (US$/tonne)	874	586	588	544	541	685	558	**491**	595
Wood:									
Lumber 2x4x8 (US$/MFBM)	335	403	383	376	390	316	345	**334**	360
Packaging:									
Linerboard 42 lb (US$/ton)	511	371	336	373	400	468	445	**427**	414
Selling price index	120%	100%	99%	94%	93%	102%			
Selling price index after Acquisition							97%	**93%**	100%

[1] Source: Pulp & Paper Week and Random Lengths.
The term "ton" refers to a short ton, an imperial unit of measurement which equals 0.9072 metric tonnes, and the term "tonne" refers to a metric tonne.
[2] Source: Consensus of analysts of normalized pricing as at November 30, 2002.

Outlook 2003

The improvement in balance between demand and supply for uncoated freesheet presents favorable prospects for the future. Strengthening our customer relationships remains a priority. We will also continue to closely monitor inventories in order to maintain optimal levels and meet the needs of our customers.

While our current environment is filled with challenges beyond our control, such as the increase in energy costs and the fluctuation of the US dollar, we remain confident that our financial rigor and approach will help us mitigate these risks.

During 2003, we expect to reap the full benefits of our quality and profitability improvement programs. Not only should we realize the full impact of our Acquisition-related synergies (we reached an annualized run-rate of US$80 million as at December 31, 2002), but we should also achieve our two-year objective of $100 million of additional profitability by the end of 2003 through higher efficiencies, improved customer base and product offerings, and reduced costs throughout our operations.

We will continue to exercise financial discipline. We intend to limit our annual capital expenditures over a business cycle to 75% of amortization, and we intend to further reduce our net-debt-to-total capitalization ratio to 45% or below by December 31, 2003.

Our goal remains to provide superior returns to our shareholders and to be well-positioned to take advantage of growth opportunities.

Management's statement of responsibility

The consolidated financial statements contained in this Annual Report are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles. Where necessary, management has made judgments and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in the Annual Report and for ensuring that this information is consistent, where appropriate, with the information and data included in the consolidated financial statements.

To discharge its responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Corporation's external auditors are responsible for auditing the consolidated financial statements and giving an opinion thereon. In addition, the Corporation maintains a staff of internal auditors whose functions include reviewing internal controls and their application on an ongoing basis.

The Board of Directors carries out its responsibility relative to the consolidated financial statements principally through its Audit Committee, consisting solely of outside directors, which reviews the consolidated financial statements and reports thereon to the Board. The Committee meets periodically with the external auditors, internal auditors and management to review their respective activities and the discharge of each of their responsibilities. Both the external auditors and the internal auditors have free access to the Committee, with or without management, to discuss the scope of their audits, the adequacy of the system of internal controls and the adequacy of financial reporting.

Raymond Royer
Raymond Royer
President and Chief Executive Officer

Christian Dubé
Christian Dubé
Senior Vice-President and Chief Financial Officer

Montréal, Québec
January 21, 2003

Auditors' report

To the Shareholders of Domtar Inc.

We have audited the consolidated balance sheets of Domtar Inc. as at December 31, 2002 and 2001 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 2002. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Domtar Inc. as at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Chartered Accountants

Raymond Chabot Grant Thornton
Raymond Chabot Grant Thornton
Chartered Accountants
General Partnership

Montréal, Québec
January 21, 2003

Consolidated earnings

Years ended December 31
(In millions of Canadian dollars, unless otherwise noted)

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Net sales	3,476	**5,490**	4,377	3,598
Operating expenses				
Cost of sales	2,736	**4,321**	3,514	2,703
Selling, general and administrative	205	**324**	256	180
Amortization	252	**398**	294	239
Closure costs (Note 5)	40	**63**	–	–
	3,233	**5,106**	4,064	3,122
Operating profit	243	**384**	313	476
Financing expenses (Note 6)	121	**192**	167	119
Amortization of deferred gain	(3)	**(5)**	(5)	(5)
Earnings before income taxes	125	**197**	151	362
Income tax expense (Note 7)	36	**56**	11	100
Net earnings	89	**141**	140	262
Per common share (Note 8)				
Net earnings				
Basic	0.39	**0.62**	0.72	1.42
Diluted	0.39	**0.61**	0.72	1.41

Consolidated retained earnings

Years ended December 31
(In millions of Canadian dollars, unless otherwise noted)

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Retained earnings at beginning of year – as reported	430	**679**	557	504
Cumulative effect of changes in accounting policies (Note 2)	(22)	**(34)**	(22)	(160)
Retained earnings at beginning of year – as restated	408	**645**	535	344
Net earnings	89	**141**	140	262
Dividends on common shares	(20)	**(32)**	(27)	(25)
Dividends on preferred shares	–	**(1)**	(2)	(3)
Premium on purchase for cancellation of common shares	–	**–**	(1)	(43)
Retained earnings at end of year	477	**753**	645	535

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated balance sheets

As at December 31
(In millions of Canadian dollars, unless otherwise noted)

	2002	2002	2001
			Restated (Note 2)
	US$ (Note 3)	$	$
Assets			
Current assets			
Cash and cash equivalents	24	**38**	36
Receivables (Note 9)	193	**304**	300
Inventories (Note 10)	466	**736**	779
Prepaid expenses	14	**22**	24
Future income taxes (Note 7)	48	**76**	29
	745	**1,176**	1,168
Property, plant and equipment (Note 11)	3,410	**5,387**	5,612
Goodwill	50	**79**	62
Other assets (Note 12)	130	**205**	213
	4,335	**6,847**	7,055
Liabilities and shareholders' equity			
Current liabilities			
Bank indebtedness	13	**20**	45
Trade and other payables (Note 13)	474	**749**	708
Income and other taxes payable	10	**15**	19
Long-term debt due within one year (Note 14)	44	**70**	38
	541	**854**	810
Long-term debt (Note 14)	1,547	**2,444**	2,883
Future income taxes (Note 7)	396	**625**	528
Other liabilities and deferred credits (Note 15)	234	**370**	408
Commitments and contingencies (Note 16)			
Shareholders' equity			
Preferred shares (Note 17)	28	**44**	48
Common shares (Note 17)	1,109	**1,752**	1,731
Contributed surplus (Note 17)	2	**3**	–
Retained earnings	477	**753**	645
Accumulated foreign currency translation adjustments (Note 19)	1	**2**	2
	1,617	**2,554**	2,426
	4,335	**6,847**	7,055

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board:

Jacques Girard, Director

Raymond Royer, Director

Consolidated cash flows

Years ended December 31
(In millions of Canadian dollars, unless otherwise noted)

	2002	**2002**	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	**$**	$	$
Operating activities				
Net earnings	89	**141**	140	262
Non-cash items:				
Amortization	269	**425**	294	239
Future income taxes (Note 7)	20	**31**	(29)	70
Amortization of deferred gain	(3)	**(5)**	(5)	(5)
Closure costs excluding write down of property, plant and equipment (Note 5)	23	**36**	–	–
Payments of closure costs (Note 5)	(6)	**(10)**	–	–
Other	9	**14**	36	27
	401	**632**	436	593
Changes in working capital and other items				
Receivables (Note 9)	14	**22**	264	100
Inventories	27	**43**	(25)	(24)
Prepaid expenses	2	**3**	(5)	5
Trade and other payables	(39)	**(62)**	38	(29)
Income and other taxes payable	7	**12**	12	(32)
Early settlement of interest rate swap contracts	25	**40**	–	–
Other	(8)	**(13)**	7	(26)
	28	**45**	291	(6)
Cash flows provided from operating activities	429	**677**	727	587
Investing activities				
Net additions to property, plant and equipment	(141)	**(223)**	(280)	(248)
Business acquisitions (Note 4)	(17)	**(27)**	(2,616)	(22)
Other	-	**1**	(5)	(12)
Cash flows used for investing activities	(158)	**(249)**	(2,901)	(282)
Financing activities				
Dividend payments	(20)	**(33)**	(28)	(28)
Change in bank indebtedness	(16)	**(25)**	(2)	(1)
Change in revolving bank credit, net of expenses	5	**9**	(196)	(163)
Issuance of long-term debt, net of expenses	–	**–**	3,791	–
Repayment of long-term debt	(250)	**(395)**	(1,879)	(6)
Common shares issued (repurchased), net of expenses	13	**21**	498	(78)
Redemptions of preferred shares	(2)	**(3)**	(3)	(3)
Cash flows provided from (used for) financing activities	(270)	**(426)**	2,181	(279)
Net increase in cash and cash equivalents	1	**2**	7	26
Cash and cash equivalents at beginning of year	23	**36**	29	3
Cash and cash equivalents at end of year	24	**38**	36	29

The accompanying notes are an integral part of the consolidated financial statements.

Notes

Note 1

Summary of significant accounting policies

The consolidated financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). These financial statements differ in certain respects from those prepared in accordance with United States generally accepted accounting principles (U.S. GAAP), and are not intended to provide certain disclosures which would typically be found in financial statements prepared in accordance with U.S. GAAP. These differences are described in Note 24.

Basis of consolidation

The consolidated financial statements include the accounts of Domtar Inc. and its subsidiaries (the Corporation) as well as its joint ventures (collectively Domtar). Investments over which the Corporation exercises significant influence are accounted for using the equity method. The Corporation's interests in joint ventures are accounted for using the proportionate consolidation method.

Use of estimates

The consolidated financial statements have been prepared in conformity with Canadian GAAP, which require management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the year, the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements. On an on-going basis, management reviews its estimates, including those related to environmental matters, amortization methods and useful lives, impairment of assets, pension and other employee future benefit plans, and income taxes based on currently available information. Actual results could differ from those estimates.

Translation of foreign currencies

Self-sustaining foreign operations

For foreign subsidiaries that are considered financially and operationally self-sustaining, the current rate method of translation of foreign currencies has been used. Under this method, assets and liabilities are translated into Canadian dollars at the rate in effect at the balance sheet date and the revenues and expenses are translated at the average exchange rates during the year. All gains and losses arising from the translation of the financial statements of these foreign subsidiaries are included in the "Accumulated foreign currency translation adjustments" account under "Shareholders' equity."

Foreign currency transactions and integrated foreign operations

For foreign currency transactions and foreign subsidiaries that are considered financially and operationally integrated, the temporal method of translation of foreign currencies has been used. Monetary items are translated at the rate in effect at the balance sheet date, non-monetary items are translated at their historical rate (as well as the related amortization) and the revenues and expenses are translated at the rate in effect at the transaction date or at the average exchange rates during the year as appropriate. Translation gains and losses, except those on long-term debt, are included in "Selling, general and administrative" expenses.

Foreign currency long-term debt

For debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account in "Shareholders' equity". The remaining long-term debt denominated in a foreign currency is designated as a hedge of future U.S. dollar revenue streams and any exchange gains and losses are deferred and recognized when the designated revenue is earned or such time as the hedge ceases to be effective.

Revenue recognition

Domtar recognizes revenue when persuasive evidence of an arrangement exists, goods have been delivered, there are no uncertainties surrounding product acceptance, the related revenue is fixed and determinable and collection is considered reasonably assured. Domtar records delivery costs as a reduction of gross sales to determine net sales. For the year ended December 31, 2002, delivery costs amounted to $357 million (2001 – $259 million; 2000 – $215 million).

Note 1 (continued)

Income taxes
Domtar uses the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of the assets and liabilities. The change in the net future tax asset or liability is included in earnings. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws expected to apply in the years in which assets and liabilities are expected to be recovered or settled. Domtar does not provide for income taxes on undistributed earnings of foreign subsidiaries that are not expected to be repatriated in the foreseeable future.

Cash and cash equivalents
Cash and cash equivalents include cash and short-term investments with original maturities of less than three months and are presented at cost, which approximates market value.

Receivables
Receivables are recorded at cost net of a provision for doubtful accounts that is based on expected collectibility. Gains or losses on sales of receivables are calculated as the difference between the carrying amount of the receivables sold and the sum of the cash proceeds on sale and the fair value of the retained subordinate interest in such receivables on the date of transfer. Fair value is determined on a discounted cash flow basis. Costs related to the sales of receivables are recognized in earnings in the period when the sale occurs.

Inventories
Inventories of operating and maintenance supplies and raw materials are valued at the lower of average cost and replacement cost. Work in process and finished goods are valued at the lower of average cost and net realizable value, and include the cost of raw materials, direct labor and manufacturing overhead expenses.

Property, plant and equipment
Property, plant and equipment are stated at cost less accumulated amortization, including asset impairment write-down. Interest costs are capitalized for major capital projects. For timber limits and timberlands, amortization is calculated using the unit of production method. For all other assets, amortization is calculated using the straight-line method over the estimated useful lives of the assets. Buildings are amortized over a maximum period of 10 to 40 years and Machinery and equipment over a maximum period of 3 to 20 years. The amortization expense is reported net of the amount of the amortization of deferred credits related to property, plant and equipment. No amortization is recorded on assets under construction.

Goodwill
Effective January 1, 2002, goodwill is no longer amortized and is subject to an annual impairment test. Prior to January 1, 2002, goodwill arising from acquisitions completed before July 1, 2001 was amortized on a straight-line basis over periods not exceeding 25 years. At each balance sheet date, Domtar assessed whether there had been a permanent impairment in the value of goodwill. This was accomplished mainly by determining whether projected undiscounted future cash flows from operations exceeded the net carrying amount of goodwill as of the assessment date.

During 2002, goodwill increased by $17 million related to business acquisitions completed by Norampac Inc. (a 50-50 joint venture with Cascades Inc.).

Other assets
Other assets are recorded at cost. Expenses and discounts related to the issuance of long-term debt are deferred and amortized on a straight-line basis over the term of the related obligation.

Deferred credits
Deferred credits comprise the deferred gain on the contribution of net assets to Norampac Inc. and its subsidiaries (Norampac), the deferred net gain on early settlement of interest swap contracts and grants and investment tax credits obtained upon the acquisition of property, plant and equipment. The deferred gain on the contribution of net assets to Norampac is amortized on a straight-line basis over 15 years. The net deferred gain on early settlement of interest rate swap contracts is amortized as adjustments to "Financing expenses" over the initially designated periods of the respective interest payments. Investment tax credits are amortized on the same basis as the related property, plant and equipment.

Environmental costs

Environmental expenditures for effluent treatment, air emission, landfill operation and closure, asbestos containment and removal, bark pile management, and sylviculture activities (together referred to as environmental matters) are expensed or capitalized depending upon their future economic benefit. In the normal course of business, Domtar incurs certain operating costs for environmental matters which are expensed as incurred. Expenditures for property, plant and equipment that prevent future environmental contamination are capitalized and amortized on a straight-line basis over 10 to 30 years. Provisions for environmental matters are not discounted and are recorded when remediation efforts are likely and can be reasonably determined.

Stock-based compensation and other stock-based payments

Domtar uses the fair value based approach of accounting for stock-based payments to non-employees and has chosen to record an expense for the stock options granted to its employees using the fair value method. Any consideration paid by plan participants on the exercise of share options or the purchase of shares is credited to stated capital.

Stock-based compensation expense is recognized over the vesting period for the options, share purchase rights and bonus shares. For employee share purchase discounts, compensation expense is recognized when employees purchase shares. The contributed surplus component of the stock-based compensation is transferred to capital stock upon the issuance of common shares.

Deferred Share Units are amortized over their vesting periods and remeasured at each reporting period, until settlement, using the quoted market value. Deferred Share Units are accounted for in compensation expense and "Other liabilities and deferred credits".

Derivative instruments

Derivative instruments are utilized by Domtar in the management of its foreign currency, price risk and interest rate exposures. Domtar uses hedging instruments to hedge changes in fair values or cash flows for items with identified exposures. Domtar also assesses, both at the hedge's inception and on an ongoing basis, the effectiveness of hedging instruments. Domtar uses hedge accounting to account for the derivative instruments formally designated as hedging instruments and the fair value method for derivative instruments not designated as hedging instruments.

Realized and unrealized gains or losses associated with hedging instruments for which the underlying hedged items are either sold, paid or terminated are recognized to earnings. Realized and unrealized gains or losses when hedging instruments have ended or cease to be effective prior to their maturity are deferred and recognized in earnings concurrently with the recognition of the item being hedged.

Domtar hedges its foreign exchange exposure on anticipated net cash inflows in U.S. dollars through the use of options and forward contracts. Resulting gains and losses, including premiums on options, are recognized when the designated sale is recognized and are included in "Net sales".

Domtar hedges its exposure to price risk associated with sales of Northern Bleached Softwood Kraft (NBSK) pulp, unbleached kraft linerboard, semi-chemical medium paper, purchases of old corrugated containers and electricity through the use of cash settled commodity swap contracts. Resulting gains and losses are recognized when realized and are included in "Net sales" and "Cost of sales", respectively.

Domtar hedges its exposure to interest rates on its long-term debt through the use of interest rate swap contracts. Amounts accounted for under interest rate swap agreements are recognized as adjustments to "Financing expenses".

Pensions

Domtar accrues the cost of defined benefit plans as determined by independent actuaries. The net periodic benefit cost includes:

- the cost of pension benefits provided in exchange of employees' services rendered during the year,
- the interest cost of pension obligations,
- the expected long-term return on pension fund assets which is based on a market-related value determined using a five-year moving average market value for equity securities and fair value for other asset classes,
- gains or losses on settlements or curtailments,

Note 1 (continued)

- the straight-line amortization of past service costs and plan amendments over the average remaining service period of the active employee group covered by the plans, and
- the amortization of cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the accrued benefit obligation or market-related value of plan assets, at the beginning of year, over the average remaining service period of the active employee group covered by the plans.

The pension plans obligations are determined in accordance with the projected benefit method prorated on services.

Other employee future benefit plans

Domtar accrues the cost of post-retirement benefits other than pensions as determined by independent actuaries. These benefits, which are funded by Domtar as they become due, include life insurance program and medical and dental benefits. Domtar amortizes the cumulative unrecognized net actuarial gains and losses in excess of 10% of the accrued benefit obligation at the beginning of the year, over the average remaining service period of the active employee group covered by the plans.

Investment tax credits

Investment tax credits are recognized in earnings as a reduction of research and development expenses when Domtar has made the qualifying expenditures and has a reasonable assurance that the credits will be realized.

Note 2

Accounting changes

2002

Stock-based compensation and other stock-based payments

On January 1, 2002, Domtar adopted the new Canadian Institute of Chartered Accountants (CICA) recommendations relating to the accounting for stock-based compensation and other stock-based payments. These recommendations require the use of a fair-value based approach of accounting for stock-based payments to non-employees. The recommendations do not require the use of the fair value method when accounting for stock-based awards to employees, except for stock-based compensation that meets specific criteria. However, Domtar has chosen to record an expense for the stock options granted to its employees using the fair value method.

In accordance with the transitional provisions of the new accounting recommendations, Domtar has adopted the new recommendations for awards granted after January 1, 2002. The effect of the adoption of the recommendations has been reflected as a charge of $4 million ($4 million net of income taxes, or $0.02 per common share) for the year ended December 31, 2002.

Foreign currency translation

On January 1, 2002, Domtar adopted the amended CICA recommendations relating to the accounting for foreign currency translation. These recommendations eliminate the requirement to defer and amortize unrealized exchange gains and losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of the fiscal year following the current reporting period.

In accordance with the transitional provisions of the amended accounting recommendations, Domtar has applied these recommendations retroactively with restatement of prior years. The cumulative effect of the adoption of the recommendations has been reflected as a charge of $14 million ($9 million net of income taxes) to opening retained earnings for the year ended December 31, 2000. Financing expenses for the years ended December 31, 2001 and 2000 were increased by $15 million ($12 million net of income taxes, or $0.06 per common share) and $18 million ($13 million net of income taxes, or $0.07 per common share), respectively, to reflect the application of these recommendations.

The Corporation has designated all of its U.S. dollar denominated long-term debt as a hedge of its net investment in self-sustaining foreign subsidiaries and, to the extent necessary, as a foreign currency hedge of its future U.S. dollar revenue streams. For such debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account. For the remaining U.S. dollar denominated long-term debt designated as a hedge of future U.S. dollar revenue streams, exchange gains and losses are deferred and recognized when the designated revenue is earned or such time as the hedge ceases to be effective.

Norampac has designated a portion of its U.S. dollar denominated long-term debt as a hedge of its net investment in self-sustaining foreign subsidiaries. For such debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries, exchange gains and losses are included in the "Accumulated foreign currency translation adjustments" account. For the remaining U.S. dollar denominated long-term debt the exchange gains and losses are included in "Financing expenses".

Goodwill and intangible assets

On January 1, 2002, Domtar adopted the new CICA recommendations relating to the accounting for goodwill and other intangible assets which require intangible assets with an indefinite life and goodwill to no longer be amortized and be tested annually for impairment. Intangible assets with a finite life will continue to be amortized over their useful life.

In accordance with the transitional provisions of the new accounting recommendations, Domtar has performed the impairment test of its goodwill and has determined that no write down for impairment was necessary. The Corporation also reclassified to timber limits and timberland an amount of $12 million recorded in goodwill in prior years. This amount, now presented under "Property, plant and equipment", meets the criteria allowing its reclassification from goodwill. For the years ended December 31, 2001 and 2000, amortization expense related to goodwill was $4 million ($4 million net of income taxes, or $0.02 per common share) and $2 million ($2 million net of income taxes, or $0.01 per common share), respectively.

Disclosure of guarantees

In February 2003, the CICA issued an accounting guideline on the financial statements disclosures to be made by a guarantor relative to its obligations under guarantees. Effective for the fiscal year beginning January 1, 2003, the accounting guideline requires the disclosure of the nature of the guarantee, approximate term of the guarantee, how it arose, the events or circumstances that would trigger performance under the guarantee, the maximum potential amount of future payments, the carrying amount of the liability, the nature of any recourse provision and any assets held as collateral. In accordance with the transitional provisions of this accounting guideline, Domtar adopted the recommendations for the year ended December 31, 2002.

2000

Income taxes

On January 1, 2000, Domtar adopted the CICA recommendations relating to the accounting for income taxes. The recommendations require the use of the asset and liability method of accounting for income taxes. Domtar has applied the recommendations on a retroactive basis without restating prior years. The cumulative effect of the adoption of the recommendations, a charge of $112 million, has been reflected as an adjustment to opening retained earnings for the year ended December 31, 2000.

Employee future benefits

On January 1, 2000, Domtar adopted the CICA recommendations relating to the accounting for employee future benefits. The recommendations outline guidance for the accounting for pensions, post-retirement and post-employment benefit costs. Domtar has applied the recommendations on a retroactive basis without restating prior years. The cumulative effect of the adoption of the recommendations, a charge of $61 million ($39 million net of income taxes), has been reflected as an adjustment to opening retained earnings for the year ended December 31, 2000.

Impact of accounting pronouncements not yet implemented

Impairment of long-lived assets

In December 2002, the CICA issued new recommendations relating to the impairment of long-lived assets. These recommendations provide accounting guidance for the determination of a long-lived asset impairment as well as recognition, measurement and disclosure of the impairment. These recommendations are effective for fiscal years beginning on or after April 1, 2003. As the impairment test is based on the recoverability for each group of assets from which cash flows are identifiable, Domtar is currently assessing the impact that this recommendation will have on its results of operations and financial position.

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 2 (continued)

Disposal of long-lived assets and discontinued operations

In December 2002, the CICA issued new recommendations relating to the disposal of long-lived assets and discontinued operations. These recommendations establish standards relating to the recognition, measurement, presentation and disclosure for the disposal of long-lived assets as well as presentation and disclosure for discontinued operations. These recommendations are effective for disposal activities initiated on or after May 1, 2003.

Hedging relationships

In November 2002, the CICA amended the accounting guideline relating to hedging relationships. This accounting guideline must be applied to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. This accounting guideline addresses the identification, designation, documentation and effectiveness of the hedging relationships for the purpose of applying hedge accounting. In addition, it deals with the discontinuance of hedge accounting and establishes conditions for applying hedge accounting. Under this guideline, documentation of the information related to hedging relationships is required and the effectiveness of the hedges must be demonstrated and documented. Domtar does not expect these recommendations to have an initial impact on its financial statements upon adoption.

Note 3

United States dollar amounts

The consolidated financial statements are expressed in Canadian dollars and, solely for the convenience of the reader, the 2002 financial statements and the tables of certain related notes have been translated into U.S. dollars at the year-end rate of CAN$1.5796 = US$1.00. This translation should not be construed as an application of the recommendations relating to the accounting for foreign currency translation, but rather as supplemental information for the reader.

Note 4

Business acquisitions

2002

During the year, Norampac acquired businesses for a cash consideration of $54 million and a transfer of assets of $14 million (the Corporation's proportionate share being $27 million and $7 million, respectively).

2001

Four U.S. mills and related assets from Georgia-Pacific

On August 7, 2001, Domtar acquired from Georgia-Pacific Corporation four integrated pulp and paper mills and related assets located in Ashdown, Arkansas, Nekoosa and Port Edwards, Wisconsin and Woodland, Maine, for a consideration in cash of $2,531 million (US$1,650 million) and $38 million of transaction related costs. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair value as of the acquisition date. The results of operations of these acquired mills were included in the consolidated financial statements from the date of acquisition. Details of the acquisition at the effective date are as follows:

	$
Net assets acquired at assigned values:	
Current assets	388
Current liabilities	(144)
Operating working capital	244
Property, plant and equipment	2,442
Other assets	8
Other liabilities	(125)
	2,569
Consideration:	
Cash, including transaction related costs	2,569

The allocation of the purchase price has been completed in 2002, and the assigned values have been modified to reflect the final plan for the integration and restructuring of assets acquired.

Assuming an effective date of January 1, 2000 for the acquisition of the four integrated pulp and paper mills and related assets, and considering the financing of the acquisition by the issuance of the term loan and the 7.875% notes mentioned in Note 14 and the common share issuance done in October 2001 mentioned in Note 17, the unaudited pro forma consolidated financial information would have been as follows for the years ended December 31:

	2001 Restated (Note 2)	2000 Restated (Note 2)
	$	$
	Unaudited	Unaudited
Net sales	5,451	5,426
Net earnings	151	374
Net earnings per common share		
Basic	0.66	1.63
Diluted	0.66	1.62

Other acquisitions
In 2001, Norampac acquired businesses for a total cash consideration of $93 million (the Corporation's proportionate share being $46.5 million).

2000

Ris Paper
On July 31, 2000, Domtar acquired all of the issued and outstanding shares of Ris Paper Company, Inc. (Ris Paper), a privately held paper distribution company in the United States. The acquisition has been accounted for using the purchase method. Ris Paper's results of operations have been included in the consolidated financial statements from the effective date of acquisition. Details of the acquisition at the effective date are as follows:

	$
Net assets acquired at assigned values:	
Operating working capital, including cash of $1 million	125
Long-term debt	(102)
Other assets and liabilities	8
	31
Consideration:	
Cash, including transaction related costs	7
1,971,861 common shares	24
	31

Assuming an effective date of January 1, 2000 for the Ris Paper acquisition, the unaudited pro forma consolidated net sales of Domtar would have been $4,015 million for the year ended December 31, 2000. The impact on net earnings and earnings per share would not have been significant.

Other acquisitions
In 2000, Domtar acquired businesses for a total cash consideration of $16 million (including the Corporation's proportionate interest in Norampac) and the assumption of $3 million of long-term debt.

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 5

Closure costs

During 2002, Domtar announced plans to permanently shut down, in September 2002, its St. Catharines, Ontario, paper mill and in January 2003, its wood products remanufacturing facility in Daveluyville, Québec and its hardwood lumber operations in Sault Ste. Marie, Ontario.

The shutdown of the mills resulted in a charge of $63 million ($42 million net of income taxes, or $0.18 per common share), which included $27 million related to the write down to the estimated net realizable value of property, plant and equipment as well as $36 million primarily for severance costs, demolition costs, site remediation as well as other commitments and contingencies related to these closures. As at December 31, 2002, the provision was drawn down to $26 million mainly due to severance payments.

During 2002, Domtar shut down a paper machine at its Nekoosa paper mill, acquired in the third quarter of 2001, as a result of a study which was part of the original plan upon acquisition. In accordance with CICA recommendations, charges related to the closure of this paper machine, amounting to $10 million (US$6 million), have been accounted for as part of the purchase price allocation of the assets acquired and liabilities assumed as of the acquisition date and thus do not affect the results for the year ended December 31, 2002.

Note 6

Financing expenses

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Interest on long-term debt	117	**185**	146	97
Unrealized exchange losses on long-term debt	–	**–**	21	21
Receivables securitization	9	**14**	4	–
Net interest recoveries related to interest rate swap contracts	(7)	**(11)**	(4)	–
Amortization of debt issue costs and other	3	**6**	8	4
	122	**194**	175	122
Less: Income from short-term investments	–	**–**	3	–
Capitalized interest	1	**2**	5	3
	121	**192**	167	119
Cash payments (cash receipts)				
Interest, net of interest income and amounts capitalized	117	**185**	128	94
Net cash receipts related to interest rate swap contracts	(37)	**(58)**	–	–
	80	**127**	128	94

Note 7

Income taxes

The following table provides a reconciliation of income taxes computed at the Canadian statutory rate to income tax expense presented on the Consolidated Earnings.

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Combined basic Canadian federal and provincial tax rate (statutory income tax rate)	37.1%	**37.1%**	39.8%	40.7%
Income tax expense based on statutory income tax rate	46	**73**	60	147
Large corporation tax	5	**7**	7	7
Canadian manufacturing and processing activities	(1)	**(2)**	(4)	(25)
Foreign rate differential	(17)	**(27)**	(12)	–
Impact of reduction in income tax rate on future income taxes	–	**–**	(39)	(16)
Reduction of valuation allowance	–	**–**	–	(14)
Other	3	**5**	(1)	1
Income tax expense	36	**56**	11	100
Income tax expense (recovery)				
Current	16	**25**	40	30
Future	20	**31**	(29)	70
	36	**56**	11	100

Net cash payments for income taxes in 2002 amounted to $3 million (2001 – $23 million; 2000 – $36 million).

The following table provides the geographic distribution of the income tax expense.

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Earnings before income taxes				
Canada	11	**17**	35	306
U.S. and other	114	**180**	116	56
	125	**197**	151	362
Current income taxes				
Canada	13	**20**	20	22
U.S. and other	3	**5**	20	8
	16	**25**	40	30
Future income taxes				
Canada	(5)	**(9)**	(41)	59
U.S. and other	25	**40**	12	11
	20	**31**	(29)	70

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 7 (continued)

Components of future income tax assets and liabilities	2002	2002	2001
			Restated (Note 2)
	US$ (Note 3)	$	$
Future income tax assets			
Accounting provisions	40	**63**	111
Loss carry forwards	126	**200**	44
Deferred credits	14	**22**	37
Pension and other employee future benefit plans	1	**1**	9
	181	**286**	201
Future income tax liabilities			
Property, plant and equipment	(525)	**(829)**	(713)
Other	(4)	**(6)**	13
	(529)	**(835)**	(700)
Total net future income tax liability	(348)	**(549)**	(499)
Net current future income tax asset	48	**76**	29
Net non-current future income tax liability	(396)	**(625)**	(528)
	(348)	**(549)**	(499)

Note 8

Earnings per share

The following table provides the reconciliation between basic and diluted earnings per share.

	2002	2002	2001	2000
			Restated (Note 2)	Restated (Note 2)
	US$ (Note 3)	$	$	$
Net earnings	89	**141**	140	262
Dividend requirements of preferred shares	–	**1**	2	3
Net earnings applicable to common shares	89	**140**	138	259
Weighted average number of common shares outstanding (millions)	227.2	**227.2**	191.2	182.9
Effect of dilutive stock options (millions)	0.9	**0.9**	0.7	0.7
Weighted average number of diluted common shares outstanding (millions)	228.1	**228.1**	191.9	183.6
Basic earnings per share	0.39	**0.62**	0.72	1.42
Diluted earnings per share	0.39	**0.61**	0.72	1.41

Note 9

Receivables

Receivables securitization

Domtar uses securitization of its receivables as a source of financing by reducing its working capital requirements. Domtar's securitizations consist of the sale of receivables on a limited recourse basis, or the sale of senior beneficial interest in them, to special purpose trusts managed by financial institutions for multiple sellers of receivables. The agreements normally allow the daily sale of new receivables to replace those that have been collected. They also limit the cash that can be received from the sale of the senior beneficial interest and require Domtar to retain a subordinate interest in those receivables. This subordinate interest is included in "Receivables" and will be collected only after the senior beneficial interest has been settled.

Domtar retains responsibility for servicing the receivables sold but does not record a servicing asset or liability as the fees received by Domtar for this service approximate the fair value of the services rendered.

In 2002, a net charge of $14 million (2001 – $4 million; 2000 – nil) resulted from the programs described below and was included in "Financing expenses". The net cash received during 2002 from the sale of senior beneficial interests in the U.S. and Canadian receivables was $26 million (2001 – $178 million; 2000 – $60 million) and was included in the Consolidated Statement of Cash Flows as a source of cash from receivables.

U.S. accounts receivable program

In January 2002, Domtar entered into an agreement, which expires in January 2004, for the securitization of U.S. receivables for a maximum cash consideration of $237 million (US$150 million). This agreement replaced a non-renewable agreement entered into in December 2001.

At December 31, the following balances were outstanding under this program:

		2002		2001
	$	US$	$	US$
Senior beneficial interest held by third parties	198	125	190	120
Subordinate interest retained by Domtar	178	113	165	104
Receivables sold	376	238	355	224

Canadian accounts receivable program

In December 2000, Domtar entered into an agreement, which expires in December 2003, for the securitization of Canadian receivables for a maximum cash consideration of $75 million.

At December 31, the following balances were outstanding under this program:

	2002	2001
	$	$
Senior beneficial interest held by third parties	66	48
Subordinate interest retained by Domtar	9	9
Receivables sold	75	57

Allowance for doubtful accounts

Receivables include an allowance for doubtful accounts of $24 million (2001 – $19 million).

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

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Note 10

Inventories

	2002 US$ (Note 3)	**2002 $**	2001 $
Work in process and finished goods	257	**406**	430
Raw materials	95	**150**	166
Operating and maintenance supplies	114	**180**	183
	466	**736**	779

Note 11

Property, plant and equipment

	2002	**2002**			2001		
	Net Carrying Amount US$ (Note 3)	**Cost $**	**Accumulated Amortization $**	**Net Carrying Amount $**	Cost $	Accumulated Amortization $	Net Carrying Amount $
Machinery and equipment	2,903	**6,517**	**1,931**	**4,586**	6,294	1,636	4,658
Buildings	324	**886**	**374**	**512**	989	335	654
Timber limits and land	119	**215**	**27**	**188**	216	24	192
Assets under construction	64	**101**	**–**	**101**	108	–	108
	3,410	**7,719**	**2,332**	**5,387**	7,607	1,995	5,612

Note 12

Other assets

	2002 US$ (Note 3)	**2002 $**	2001 Restated (Note 2) $
Accrued benefit asset – defined benefit pension plans	72	**114**	88
Unamortized debt issue costs	22	**34**	41
Investments and advances	16	**26**	55
Discount on long-term debt	7	**11**	12
Other	13	**20**	17
	130	**205**	213

Note 13 Trade and other payables

	2002 US$ (Note 3)	**2002 $**	2001 $
Trade accounts payable	276	**436**	382
Payroll-related accruals	92	**145**	143
Accrued interest	28	**45**	42
Payables on capital projects	14	**22**	26
Accrued benefit liability – defined benefit pension plans	4	**6**	7
Accrued benefit liability – other employee future benefit plans	2	**4**	4
Provision for environment	12	**19**	8
Closure costs excluding costs for defined benefit pension plans and site remediation	12	**19**	–
Other	34	**53**	96
	474	**749**	708

Note 14 Long-term debt

	Maturity	2002 US$ (Note 3)	**2002 $**	2001 $
The Corporation				
Unsecured debentures and notes				
8.75% Notes (2002 and 2001 – US$150)	2006	150	**237**	239
10% Debentures	2011	52	**82**	82
7.875% Notes (2002 and 2001 – US$600)	2011	600	**948**	955
9.5% Debentures (2002 and 2001 – US$125)	2016	125	**197**	199
10.85% Debentures	2017	47	**75**	75
Unsecured term loan (2002 – US$480; 2001 – US$730)	2006	480	**758**	1,163
Other		11	**18**	20
		1,465	**2,315**	2,733
Norampac				
Unsecured notes				
9.5% Notes (2002 and 2001 – US$75)	2008	75	**119**	119
9.375% Notes	2008	32	**50**	50
Reducing revolving credit facility secured (2002 and 2001 – €4)	2003	4	**6**	6
Revolving credit facility secured (2002 – CA $10 and €1; 2001 – €1)	2003	8	**13**	2
Other		7	**11**	11
		126	**199**	188
		1,591	**2,514**	2,921
Less: Due within one year		44	**70**	38
		1,547	**2,444**	2,883

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 14 (continued)

As at December 31, 2002, principal long-term debt repayments, including capital lease obligations, in each of the next five years amounted to:

2003	2004	2005	2006	2007
$	$	$	$	$
70	51	51	850	2

The Corporation

Unsecured debentures and notes

The 10% and 10.85% debentures each have purchase fund requirements, whereby the Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, a portion of the aggregate principal amount of the debentures at prices not exceeding par.

On September 1, 2001, the Corporation redeemed the $49 million 10.35% debentures at a redemption price of 101.2% of the principal amount.

On October 16, 2001, the Corporation issued $937 million (US$600 million) 7.875% notes due in 2011 at an issue price of $925 million (US$592 million).

Bank facilities

On August 7, 2001, the Corporation borrowed $1,380 million under two 12-month bridge loans ($460 million under an equity bridge loan and US$600 million under a bond bridge loan) and $1,534 million (US$1,000 million) under a five-year term loan facility denominated in U.S. dollars. In addition, this bank facility included a US$500 million unsecured revolving credit facility expiring in 2006. These transactions were entered into in conjunction with the initial financing of the acquisition of the four integrated pulp and paper mills described in Note 4.

In October 2001, the Corporation used the proceeds from the issuance of common shares described in Note 17 and from the issuance of the 7.875% notes described above to repay the balances of the bridge loans and to reduce the term loan.

In November 2002, the Corporation terminated prior to maturity its interest rate swaps entered into in 2001. As described in Note 18, these swaps had been designated as a hedge of a portion of the interest on the 7.875% notes payable.

The unsecured term loan bears interest based on the U.S. dollar LIBOR rate or U.S. prime rate, plus a margin that varies with Domtar's credit rating and requires repayment of 23% (2001 – 25%) of the balance currently outstanding through April 30, 2006, prior to its maturity in August 2006. In 2002, the Corporation repaid $392 million (US$250 million) (2001 – $430 million (US$270 million)) of this term loan.

Borrowings under the unsecured revolving credit facility bear interest at a rate based on Canadian dollar bankers' acceptance or U.S. dollar LIBOR rate or prime rate, plus a margin that varies with Domtar's credit rating.

As at December 31, 2002, $8 million (2001 – $15 million) of borrowings under the unsecured revolving credit facility were outstanding in the form of overdraft and included in "Bank indebtedness." In addition, as at December 31, 2002, the Corporation had outstanding letters of credit pursuant to this bank credit for an amount of $9 million (2001 – $11 million).

During 2002, the interest rates on outstanding borrowings under the bank facilities ranged from 2.63% to 5.50% (2001 – from 3.16% to 7.50%).

The Corporation's borrowing agreements contain restrictive covenants. In particular, the Corporation's US$500 million unsecured revolving credit facility contains covenants that require compliance with certain financial ratios on a quarterly basis. Also, the indentures related to the 10% and 10.85% debentures limit the amount of dividends that the Corporation may pay, the amount of shares that it may repurchase for cancellation and the amount of new debt it may incur. The Corporation's bank facility also requires commitments fees in accordance with standard banking practices.

Norampac

As at December 31, 2002, Norampac had a credit agreement with a syndicate of banks with respect to a reducing revolving credit facility of $39 million (2001 – $39 million) and a revolving credit facility of $75 million (2001 – $75 million) (together the "Bank Credit"). Borrowings under the Bank Credit are not guaranteed by the Corporation, and are secured by all the receivables and inventories of Norampac and by property, plant and equipment of Norampac having a net carrying amount of $127 million (2001 – $127 million). Borrowings under the Bank Credit bear interest at floating rates plus a margin based on Norampac's consolidated leverage ratio. As at December 31, 2002, the interest rates on outstanding borrowings under the reducing revolving credit facility and the revolving credit facility were 3.75% and between 3.46% and 4.25% (2001 – 3.81% and 4.38%), respectively.

Note 15 Other liabilities and deferred credits

	2002 US$ (Note 3)	2002 $	2001 $
Other liabilities			
Accrued benefit liability – other employee future benefit plans	54	**85**	81
Accrued benefit liability – defined benefit pension plans	22	**36**	39
Provision for contracts assumed	20	**31**	69
Provision for environment	36	**56**	68
Other	31	**49**	72
Deferred credits			
Deferred gain on contribution of net assets to Norampac	30	**48**	53
Deferred net gain on early settlement of interest rate swap contracts	25	**40**	–
Investment tax credits and other	16	**25**	26
	234	**370**	408

Note 16 Commitments and contingencies

Environment

Domtar is subject to environmental laws and regulations enacted by federal, provincial, state and local authorities.

In 2002, Domtar's operating expenditures for environmental matters, as described in Note 1, amounted to $66 million (2001 – $53 million; 2000 – $33 million).

Domtar made capital expenditures for environmental matters of $20 million in 2002 (2001 – $21 million; 2000 – $9 million), for the improvement of air emissions, effluent treatment as well as remedial actions to address environmental compliance. At this time, Domtar cannot reasonably estimate the additional capital expenditures that may be required. However, management expects any additional required expenditure would not have a material adverse effect on Domtar's financial position, earnings or cash flows.

Domtar continues to take remedial action under its Care and Control Program at a number of former operating sites, especially in the wood preserving sector, due to possible soil, sediment or groundwater contamination. The investigation and remediation process is lengthy and subject to the uncertainties of changes in legal requirements, the development of technological applications and the allocation of liability among potentially responsible parties.

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 16 (continued)

While Domtar believes that it has determined the costs for environmental matters likely to be incurred in the next several years, based on known information, Domtar's ongoing efforts to identify potential environmental concerns that may be associated with its properties may lead to future environmental investigations. These efforts may result in the determination of additional environmental costs and liabilities which cannot be reasonably estimated at this time.

As at December 31, 2002, Domtar had a provision of $75 million (2001 – $76 million) for environmental matters. Additional costs, not known or identifiable, could be incurred for remediation efforts. Based on policies and procedures in place to monitor environmental exposure, management believes that such additional remediation costs would not have a material adverse effect on Domtar's financial position, earnings or cash flows.

As at December 31, 2002, anticipated payments in each of the next five years were as follows:

2003	2004	2005	2006	2007	Thereafter	Total
$	$	$	$	$	$	$
19	9	3	3	3	38	75

Contingencies

Domtar is party to claims and lawsuits mostly related to allegations of breach of contract and damage caused by its products or its installations. These allegations are being contested and management believes that the resolution of these claims and lawsuits would not have a material adverse effect on Domtar's financial position, earnings or cash flows.

E.B. Eddy acquisition

On July 31, 1998, Domtar acquired all of the issued and outstanding shares of E.B. Eddy Limited and E.B. Eddy Paper, Inc. (E.B. Eddy), an integrated producer of specialty paper and wood products. The purchase agreement includes a purchase price adjustment whereby, in the event of the acquisition by a third party of more than 50% of the shares of the Corporation in specified circumstances, the Corporation may have to pay up to a maximum of $120 million, an amount which will gradually decline over a 25-year period. No provision was recorded related to this potential purchase price adjustment.

Lease and other commercial commitments

The Corporation have entered into operating leases for property, plant and equipment. The Corporation also has commitments to purchase roundwood, wood chips, gas, electricity and certain chemicals. Minimum future payments under these operating leases and other commercial commitments, determined as at December 31, 2002, were as follows:

	2003	2004	2005	2006	2007	Thereafter	Total
	$	$	$	$	$	$	$
Operating leases	31	26	17	13	8	20	115
Other commercial commitments	63	38	28	27	23	45	224

Total operating lease expense amounted to $45 million in 2002 (2001 – $32 million; 2000 – $23 million).

Norampac has entered into operating leases for property, plant and equipment. Norampac also has commitments to purchase gas, electricity and steam. The Corporation's proportionate share of Norampac's minimum future payments under these operating leases and other commercial commitments, determined as at December 31, 2002, were as follows:

	2003	2004	2005	2006	2007	Thereafter	Total
	$	$	$	$	$	$	$
Operating leases	8	7	4	4	3	11	37
Other commercial commitments	9	10	9	8	5	–	41

The Corporation's proportionate share of Norampac's total operating leases expense amounted to $8 million in 2002 (2001 – $6 million; 2000 – $5 million).

Note 17 Stated capital

Preferred shares

The outstanding preferred shares at December 31 were as follows:

	2002	2002		2001	
	US$ (Note 3)	Number of shares	$	Number of shares	$
Preferred shares					
Series A	1	69,576	2	69,576	2
Series B	27	1,710,000	42	1,830,000	46
	28		44		48

The authorized preferred shares consist of preferred shares issuable in an unlimited number of series, ranking equal with respect to the payment of dividends and the distribution of assets.

The Series A Preferred shares are non-voting and redeemable at the Corporation's option at $25.00 per share since April 1, 1994. These shares carry a cumulative cash dividend per share of $2.25 per annum.

The Series B Preferred shares are non-voting and redeemable at the Corporation's option at $25.00 per share. These shares carry a cumulative cash dividend equivalent to 72% of the bank prime rate.

The Corporation has undertaken to make all reasonable efforts to purchase quarterly, for cancellation, 1% of the number of Series A and Series B Preferred shares outstanding on April 2, 1992 at prices not exceeding $25.00 per share. In connection therewith, Preferred shares purchased for cancellation were as follows:

	2002		2001		2000	
	Number of shares	Average price per share $	Number of shares	Average price per share $	Number of shares	Average price per share $
Series B	120,000	23.66	120,000	23.06	120,000	20.62

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 17 (continued)

Common shares

The Corporation is authorized to issue an unlimited number of common shares. The changes in the number of outstanding common shares and their aggregate stated value from January 1, 2000 to December 31, 2002 were as follows:

	2002		2002		2001		2000
	US$ (Note 3)	Number of shares	$	Number of shares	Restated (Note 2) $	Number of shares	Restated (Note 2) $
Balance at beginning of year	1,096	**226,202,379**	**1,731**	180,394,416	1,224	184,139,827	1,234
Shares issued							
Shares issued for cash, net of expenses	–	–	–	45,209,790	499	–	–
Acquisition of Ris Paper	–	–	–	–	–	1,971,861	24
Stock option and share purchase plans	13	**1,477,973**	**21**	881,573	10	623,128	8
Shares purchased for cancellation	–	–	–	(283,400)	(2)	(6,340,400)	(42)
Balance at end of year	1,109	**227,680,352**	**1,752**	226,202,379	1,731	180,394,416	1,224
Book value per common share at end of year	6.98		**11.02**		10.51		9.75

On October 5, 2001, the Corporation issued 40,209,790 common shares at $11.44 per share for a total gross consideration of $460 million or $444 million net of underwriting discount, other offering expenses, and related income taxes of $7 million. On October 25, 2001, the Corporation issued an additional 5,000,000 common shares, in conjunction with the exercise of the over-allotment option granted by the Corporation to the underwriters, for gross proceeds of $57 million or $55 million net of underwriting discount and related income taxes of $1 million.

During 2002, the Corporation did not purchase for cancellation any of its common shares. In 2001, 283,400 shares (2000 – 6,340,400 shares) were purchased for cancellation under a Normal Course Issuer Bid at an average price per share of $12.22 (2000 – $13.54 per share). The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

Book value per common share is the sum of the stated value of common shares, retained earnings and accumulated foreign currency translation adjustments divided by the number of common shares outstanding at year end.

Warrants

On December 23, 2002, in order to facilitate the orderly distribution of the common shares held by one of its major shareholders, the Société générale de financement du Québec (SGF), through one of its indirect wholly owned subsidiaries Dofor Inc. (Dofor), the Corporation issued 18,170,249 units comprised of one warrant and one common share held by Dofor. Each whole warrant will entitle the holder to purchase one common share at a price of $17.55, at any time on or prior to December 23, 2003, after which date the warrant will become null and void. The warrant agreement requires the Corporation to cause to be delivered, or issue, to the holders upon exercise of the warrants, that number of common shares to which such holder is entitled.

Under a delivery agreement between the Corporation, Dofor, SGF Rexfor, SGF, and the warrant agent, as depository and delivery agent, Dofor has irrevocably committed and agreed to deliver the common shares from its holding of the Corporation common shares to the holders of warrants upon their due exercise.

The delivery agreement provides that each of Dofor, SGF Rexfor and SGF will indemnify the Corporation against any and all losses, damages or liabilities to which the Corporation may become subject arising out of or based upon any default of Dofor. The obligations of Dofor under the delivery agreement are irrevocably and unconditionally guaranteed by SGF Rexfor and SGF.

The warrants have not been included in the computation of diluted earnings per share.

Executive stock option and share purchase plan

Under the Executive Stock Option and Share Purchase Plan (the "Plan"), options and rights may be granted to selected eligible employees. Options are granted at a price equal to the market value on the day immediately preceding the date the options were granted and generally expire ten years after the date of the grant. Normally, one quarter of the options may be exercised at each anniversary date of the grant. Rights permit eligible employees to purchase shares at 90% of the quoted market value on the day immediately preceding the date the rights were granted, and provide for a one-for-four bonus share to be issued on the third anniversary date of the exercise of the rights.

During the second quarter of 2001, all of the 900,000 performance options granted in March 1997 became void as a result of not meeting the specified conditions to exercise the options based on the market value of the Corporation's common shares. A new performance option program was then approved, and 1,050,000 stock options were granted to members of the senior management team. Pursuant to this grant, and except in certain specified circumstances, there is no pro rata or early vesting prior to January 1, 2004, at which time the options become fully vested if the holder of the options is an employee of Domtar at that time. After vesting, the options may not be exercised unless both of the following two conditions have been met: 1) at any time between January 1, 2001 and December 31, 2003, the weighted average trading price of the Corporation's common shares during 20 consecutive trading days on the Toronto Stock Exchange has reached or exceeded: $16.70, $18.51 or $20.32, whereupon 25%, 50% or 100%, respectively, of the options granted become exercisable; and 2) the appreciation in the market value of the Corporation's common shares between January 1, 2001 and the exercise date is equal to or exceeds the increase in the Standard & Poor's U.S. Paper & Forest Products index during the same period. The new performance options have a term of seven years and expire in June 2008.

The fair value of options granted during the years ended December 31, 2002, 2001 and 2000 was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2002	2001	2000
Risk-free interest rate	**5.2%**	5.7%	6.0%
Annual dividends per share (in dollars)	**$0.14**	$0.14	$0.14
Expected lives (years)	**6**	6	6
Volatility	**34.4%**	34.5%	33.5%
Weighted average fair value of options granted during the year (in dollars per option)	**$6.54**	$3.29	$6.52

As at December 2002, the Corporation had a receivable from its employees of $11 million (2001 – $8 million) related to share purchase loans granted to them under this plan. These shares are held in trust as security for the loans that are interest bearing and with defined repayment terms not exceeding 10 years. At the end of the year, there were 1,000,333 shares (2001 – 800,994 shares) held in trust in respect to employee loans for which the market value was $15.70 (2001 – $16.01) per share. These loans were included in "Other Assets".

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 17 (continued)

Changes in the number of options outstanding were as follows:

	2002		2001		2000	
	Number of options	**Weighted average exercise price**	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
		$		$		$
Outstanding at beginning of year	**4,573,233**	**12.29**	3,602,023	11.76	3,058,465	10.59
Granted	**1,212,000**	**16.52**	2,266,950	12.86	747,000	16.08
Exercised	**614,827**	**9.99**	227,769	9.67	125,091	9.43
Cancelled	**249,524**	**13.51**	1,067,971	12.29	78,351	10.94
Outstanding at end of year	**4,920,882**	**13.56**	4,573,233	12.29	3,602,023	11.76
Options exercisable at end of year	**1,533,085**		1,508,596		1,118,197	

The following table summarizes information about options outstanding and exercisable at December 31, 2002:

	Options outstanding			Options exercisable	
Range of exercise prices	Number of options	Weighted average remaining contractual life	Weighted average exercise price	Number of options	Weighted average exercise price
			$		$
\$6.38 – \$9.25	148,917	3.9	8.95	148,917	8.95
\$9.48 – \$11.00	873,069	5.1	10.21	742,559	10.33
\$11.25 – \$12.75	964,144	7.9	12.12	304,707	12.18
\$13.00 – \$16.52	2,934,752	7.5	15.25	336,902	16.12
	4,920,882	7.0	13.56	1,533,085	11.84

During the year, 358,472 shares (2001 – 294,120; 2000 – 209,672) were issued pursuant to the exercise of rights and 40,878 bonus shares (2001 – 22,682; 2000 – 16,329) were issued. The total expense recognized in Domtar's results of operations related to these rights and bonus shares amounted to $1 million in 2002. As at December 31, 2002, 191,583 bonus shares could be issued over the next three years.

As at December 31, 2002, 11,300,000 common shares (2001 – 10,000,000; 2000 – 10,000,000) were authorized for issuance under the Plan. Since its inception, 4,301,071 shares have been issued under this plan.

During the year, under the Executive stock option and share purchase plan and the Employee share purchase plans, as described below, $3 million was included in "Contributed surplus" in conjunction with the recognition of stock based compensation expense.

Deferred Share Units Plan

Outside directors

Under the Deferred Share Units Plan for outside directors, deferred share units (DSU), equivalent in value to a common share, may be granted to eligible directors. In addition, directors may elect to receive their annual retainer and attendance fees in DSU. A participant shall receive, not later than the 31st of January following the end of the year during which the participant ceases to be a member of the Board of Directors, a lump sum payment in cash equal to the number of DSU recorded in the participant's account on the termination date multiplied by the termination value of the common shares or, if the participant so elects, a number of common shares to be purchased on the open market equal to the number of DSU then recorded in the participant's account. Upon payment in full of the DSU, they shall be cancelled. The total expense recognized in Domtar's results of operations amounted to $0.2 million in 2002 (2001 – $2 million). Since the inception of the plan, 137,006 DSU have been authorized and issued.

Executives

Under the Deferred Share Units Plan for executives, DSU may be granted to eligible executives. A participant shall receive, no later than 31st of January following the end of the year during which the participant's date of retirement, death or determination of long-term disability occurred, a lump sum payment in cash equal to the number of DSU recorded in the participant's account on one of these dates multiplied by the redemption of the common shares or, if the participant so elects, a number of common shares to be purchased on the open market equal to the number of DSU then recorded in the participant's account. Upon payment in full of the DSU, they shall be cancelled. The total expense recognized in Domtar's results of operation amounted to $1 million in 2002 (2001 – nil), representing 82,110 units authorized and issued since the inception of the plan.

Employee Share Purchase Plans

Under the Employee Share Purchase Plans, all employees are eligible to purchase common shares at a price of 90% of the quoted market value. Common shares are purchased under the plans on monthly investment dates. Shares purchased under the Canadian plan are subject to a mandatory twelve-month holding period. Employees who hold the shares for 18 months following the date of acquisition (U.S. plan) or who hold the shares purchased in any calendar year until June 30 of the following year (Canadian plan) are entitled to receive additional common shares equivalent to 10% of the cost of such shares. As at December 31, 2002, 5,050,000 common shares (2001 – 3,350,000; 2000 – 3,350,000) were authorized for issuance under the plans. During the year, 463,796 common shares (2001 – 337,002; 2000 – 272,036) were issued under the plans at an average price of $16.49 (2001 – $12.66; 2000 – $13.22) per share. Since their inception, 3,591,862 shares have been issued under these plans.

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 18

Financial instruments

Fair value of financial instruments

	2002		2002		2001	
	Fair value	Carrying amount	**Fair value**	**Carrying amount**	Fair value	Carrying amount
	US$ (Note 3)	US$ (Note 3)	**$**	**$**	$	$
Long-term debt	1,782	1,591	**2,815**	**2,514**	3,015	2,921

The fair value of the long-term debt, including the portion due within one year, is principally based on quoted market prices.

Due to their short-term maturity, the carrying amounts of cash and cash equivalents, receivables, bank indebtedness and trade and other payables approximate their fair values.

Interest rate risk

Domtar's exposure to interest rate risk is as follows:

Cash and cash equivalents	Floating rate and non-interest bearing
Receivables	Floating rate and non-interest bearing
Bank indebtedness	Floating rate and non-interest bearing
Trade and other payables	Non-interest bearing
Bank credit facility	Floating rate

The following represents Domtar's carrying amount of long-term debt by date of repayment, based on maturity date or management's expectation to repurchase long-term debt when debentures have purchase fund requirements. Management's expectation reflects prevailing market conditions.

Long-term debt	$	
Maturing in 1 year or less:	2	Fixed interest rate
Maturing in 1 year or less:	68	Variable interest rate
Maturing in 2 to 5 years:	245	Fixed interest rate
Maturing in 2 to 5 years:	709	Variable interest rate
Maturing in 6 to 10 years:	1,204	Fixed interest rate
Maturing in 6 to 10 years:	4	Variable interest rate
Maturing in 11 or more years:	282	Fixed interest rate

In 2001, the Corporation had entered into interest rate swap contracts for a nominal value of $956 million (US$600 million) ending in October 2006. These swaps were designated as hedges of a portion of the interest on the 7.875% notes payable until the swaps' maturity. These interest rate swap contracts were comprised of two components. Under the terms of the first component of these swaps, the Corporation would receive, on a semi-annual basis, an average fixed interest rate of 4.45% on $956 million (US$600 million) until October 2006 and under the terms of the second component, the Corporation would pay 2.48% on $478 million (US$300 million) until October 2002 and 3.16% on $478 million (US$300 million) until October 2003. The interest paid on the two parts after these initial dates until October 2006 would be calculated based on the LIBOR three-month rate. As at December 31, 2001, these interest rate swap contracts had a negative fair value of $19 million (US$12 million), the second component having a negligible fair value.

In November 2002, the Corporation terminated, prior to maturity, these interest rate swap contracts for net cash proceeds of $40 million (US$26 million) recorded under "Other liabilities and deferred credits". The first component generated a gain of $51 million (US$33 million) and the second component generated a loss of $11 million (US$7 million). The amounts were deferred and will be recognized against financing expenses over the period of the interest rate payments ending in October 2006 and October 2003, respectively, initially hedged by these interest rate swap contracts. The net recognized amounts will be $4 million (US$3 million), $13 million (US$8 million), $13 million (US$8 million) and $10 million (US$7 million) in 2003, 2004, 2005 and 2006, respectively.

Norampac has interest rate swap contracts having nominal values of $3 million (US$2 million) (2001 – $3 million (US$2 million)) and $2 million (US$1 million) (2001 – $2 million (US$1 million)), respectively, according to the Corporation's proportionate share. Under the terms of these swaps, maturing in December 2008, and October 2012, respectively, Norampac will, on a monthly basis, receive interest calculated on the LIBOR one-month rate plus 1.5%, and pay an average fixed rate of 7.25% and 9.47%, respectively. Norampac is holding these derivative financial instruments for speculative purposes and, accordingly, the derivatives are recorded at their fair value. As at December 31, 2002, the first swap has a negative fair value of $1 million (US$1 million) while the second swap has negligible value. Both swaps had a negligible fair value as at December 31, 2001.

Credit risk

Domtar is exposed to credit risk on the accounts receivable from its customers. In order to reduce this risk, Domtar reviews new customers' credit histories before granting credit and conducts regular reviews of existing customers' credit performance. As at December 31, 2002, one of Domtar's paper segment customers, located in the United States, represented 11% ($60 million) of the receivables prior to the effect of the receivables securitization.

Domtar is also exposed to credit risk in the event of non-performance by counterparties to its financial instruments. Domtar minimizes this exposure by entering into contracts with counterparties that are believed to be of high credit quality. Collateral or other security to support financial instruments subject to credit risk is usually not obtained. The credit standing of counterparties is regularly monitored.

Note 18 (continued)

Foreign currency risk

In order to reduce the potential negative effects of a fluctuating Canadian dollar, Domtar has entered into various arrangements to stabilize anticipated future net cash inflows denominated in U.S. dollars. The following table provides the detail of the arrangements used as hedging instruments.

	Average exchange rate CAN$/US$		Contractual amounts (In millions of U.S. dollars)	
	2002	2001	**2002**	2001
Forward foreign exchange contracts				
0 to 12 months	**1.50**	1.46	**132**	305
13 to 24 months	**–**	1.49	**–**	131
Currency options purchased				
0 to 12 months	**1.43**	1.44	**144**	376
13 to 24 months	**–**	1.43	**–**	209
25 to 36 months	**–**	1.48	**–**	85
Currency options sold				
0 to 12 months	**1.51**	1.53	**144**	376
13 to 24 months	**–**	1.52	**–**	209
25 to 36 months	**–**	1.60	**–**	85

Forward foreign exchange contracts are contracts whereby Domtar has the obligation to sell U.S. dollars at a specific rate.

Currency options purchased are contracts whereby Domtar has the right, but not the obligation, to sell U.S. dollars at the strike rate if the U.S. dollar trades below that rate. Currency options sold are contracts whereby Domtar has the obligation to sell U.S. dollars at the strike rate if the U.S. dollar trades above that rate.

In addition to the above arrangements and as a result of the early settlement of certain currency options, the Corporation was left with freestanding written call options requiring the Corporation to sell US$65 million at an average rate of 1.54 if rates exceed in average 1.54 in 2003 and US$33 million at 1.60 if rates exceed 1.60 in 2004. These freestanding written call options do not qualify for hedge accounting and, accordingly, any fluctuations of their fair value are recorded to earnings. The impact has been reflected as a charge of $2 million for the year ended December 31, 2002. The negative fair value of the freestanding written call options, recorded under "Other liabilities and deferred credits" and "Trade and other payables" was $6 million as at December 31, 2002.

The fair value of derivative financial instruments generally reflects the estimated amounts that Domtar would receive or pay to settle the contracts at December 31, 2002 and 2001. As at these dates, the spot exchange rates were $1.58 and $1.59, respectively, and the fair value of the above derivative financial instruments used as hedging items was as follow:

	2002 US$ (Note 3)	**2002 $**	2001 $
Unrealized loss on forward foreign exchange contracts	(7)	**(11)**	(51)
Unrealized loss on currency options	(8)	**(12)**	(44)

Price risk

During 2002, the Corporation entered into a cash settled commodity swap agreement to manage price risk associated with sales of NBSK pulp covering a period starting November 2002 and ending October 2005. The agreement fixes the sale price of NBSK pulp for 1,500 tonnes per month for 36 months. The fair value of these instruments, as at December 31, 2002, represented a net unrealized gain of $1 million.

Norampac enters into cash settled commodity swap agreements to manage price risk associated with sales of unbleached kraft linerboard and semi-chemical medium paper as well as purchases of old corrugated containers and electricity. As at December 31, 2002, Norampac had entered into contracts expiring in 2003 through 2007. According to the Corporation's proportionate share, these derivative agreements fix the sale price for 98,600 tons (2001 – 159,750 tons) of kraft linerboard and 14,500 tonnes of semi-chemical medium paper (2001 – nil) and fix the purchase price for 439,850 tonnes (2001 – 16,200 tonnes) of old corrugated containers and 161,630 megawatts of electricity (2001 – nil). The fair value of these instruments, as at December 31, 2002, represented a net unrealized loss of $1 million (2001 – net unrealized gain of $2 million).

Note 19

Accumulated foreign currency translation adjustments

	2002 US$ (Note 3)	**2002 $**	2001 $	2000 $
Balance at beginning of year	1	**2**	(1)	(1)
Effect of changes in exchange rates during the year:				
On the net investment in self-sustaining foreign subsidiaries	(11)	**(18)**	85	(1)
On certain long-term debt denominated in foreign currencies designated as a hedge of the net investment in self-sustaining foreign subsidiaries	11	**18**	(82)	1
Balance at end of year	1	**2**	2	(1)

Note 20

Interests in joint ventures

The following amounts represent the Corporation's proportionate interests in its joint ventures (Norampac and Anthony-Domtar Inc.):

	2002 US$ (Note 3)	**2002 $**	2001 Restated (Note 2) $
Assets			
Current assets	104	**164**	156
Long-term assets	314	**497**	477
Liabilities			
Current liabilities	74	**116**	98
Long-term liabilities	170	**268**	271

Notes to consolidated financial statements — December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 20 (continued)

	2002 US$ (Note 3)	2002 $	2001 Restated (Note 2) $	2000 Restated (Note 2) $
Earnings				
Net sales	382	**603**	542	524
Operating profit	46	**72**	82	100
Financing expenses	11	**18**	23	22
Net earnings	24	**37**	41	52
Cash flows				
Cash flows provided from operating activities	34	**54**	71	111
Cash flows used for investing activities	(35)	**(55)**	(93)	(50)
Cash flows provided from (used for) financing activities	3	**4**	9	(42)

Note 21

Pension plans

Defined contribution plans

Domtar contributes to several defined contribution, multi-employer and 401(k) plans. The pension expense under these plans is equal to Domtar's contribution. The 2002 pension expense was $20 million (2001 – $11 million; 2000 – $4 million).

Defined benefit plans

Domtar has several defined benefit pension plans covering substantially all employees, including one closed plan for certain non-unionized employees in Canada. Non-unionized employees in Canada joining Domtar after January 1, 2000 participate in defined contribution plans. The defined benefit plans are generally contributory in Canada and non-contributory in the United States. The pension expense and the obligation related to the defined benefit plans are actuarially determined using management's most probable assumptions.

Components of net periodic benefit cost for defined benefit plans	2002 US$ (Note 3)	2002 $	2001 $	2000 $
Service cost for the year	20	**31**	24	19
Interest expense	44	**69**	67	62
Expected return on plan assets	(51)	**(81)**	(77)	(73)
Curtailment and settlement loss	1	**2**	–	–
Amortization of past service costs	–	**1**	1	–
Net periodic benefit cost for defined benefit plans	14	**22**	15	8

As a result of the closure of its St. Catharines, Ontario paper mill, during 2002, Domtar recognized a curtailment loss of $1 million and a settlement loss of $1 million. These two items were included in the closure costs as described in Note 5.

Domtar's funding policy is to contribute annually the amount required to provide for benefits earned in the year and to fund past service obligations over periods not exceeding those permitted by the applicable regulatory authorities. Past service obligations primarily arise from improvements to plan benefits. The latest actuarial valuations were conducted as at December 31, 2001 for plans representing approximately 75% of the total plans asset fair value. These valuations indicated a funding deficiency. Domtar expects to contribute for a total amount of $67 million in 2003 compared to $53 million in 2002.

Change in accrued benefit obligation

The following table represents the change in the accrued benefit obligation as determined by independent actuaries.

	2002 US$ (Note 3)	**2002 $**	2001 $
Accrued benefit obligation at beginning of year	664	**1,049**	956
Service cost for the year	20	**31**	24
Interest expense	44	**69**	67
Plan participants' contributions	8	**12**	13
Acquisitions	–	**–**	8
Amendments	(1)	**(1)**	2
Actuarial losses	15	**24**	35
Benefits paid	(41)	**(64)**	(58)
Settlement	(3)	**(5)**	–
Curtailment	1	**1**	–
Effect of foreign currency exchange rate changes	–	**–**	1
Other	–	**1**	1
Accrued benefit obligation at end of year	707	**1,117**	1,049

Change in fair value of defined benefit plan assets

The following tables represents the change in the fair value of assets of defined benefit plans reflecting the actual return on plan assets, the contributions and the benefits paid during the year.

	2002 US$ (Note 3)	**2002 $**	2001 $
Fair value of defined benefit plan assets at beginning of year	589	**930**	958
Actual return on plan assets	(17)	**(26)**	(8)
Employer contributions	34	**53**	20
Plan participants' contributions	8	**12**	13
Acquisitions	–	**–**	2
Benefits paid	(41)	**(64)**	(58)
Settlement	(3)	**(5)**	–
Effect of foreign currency exchange rate changes	–	**–**	1
Other	–	**–**	2
Fair value of defined benefit plan assets at end of year	570	**900**	930

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 21 (continued)

Description of funded assets

The assets of the pension plans are held by a number of independent trustees and are accounted for separately in the Domtar pension funds. Based on the fair value of the assets held at December 31, 2002, the plan assets are comprised of 3% in cash and short-term investments, 47% in bonds, 50% in Canadian, U.S. and foreign equities.

Domtar has indemnified and held harmless the trustees of Domtar pension funds, and the respective officers, directors, employees and agents of such trustees, from any and all costs and expenses arising out of the performance of their obligations under the relevant trust agreements, including in respect of their reliance on authorized instructions of Domtar or for failing to act in the absence of authorized instructions. These indemnifications survive the termination of such agreements. As at December 31, 2002, Domtar has not recorded a liability associated with these indemnifications, as Domtar does not expect to make any payments pertaining to these indemnifications.

Reconciliation of funded status to amounts recognized in Consolidated Balance Sheets

The following table presents the difference between the fair value of the defined benefit pension assets and the actuarially determined accrued benefit obligation as at December 31, 2002 and 2001. This difference is also referred to as either the deficit or surplus, as the case may be, or the funded status of the plans.

The table further reconciles the amount of the surplus or deficit (funded status) to the net amount recognized in the Consolidated Balance Sheets. This difference between the funded status and the net amount recognized in the Consolidated Balance Sheets, in accordance with Canadian GAAP, represents the portion of the surplus or deficit not yet recognized for accounting purposes. Deferred recognition is a guiding principle of these standards. This approach allows for a gradual recognition of changes in accrued benefit obligations and plan performance over the expected average remaining service life of the employee group covered by the plans.

	2002 US$ (Note 3)	2002 $	2001 $
Funded status	(137)	**(217)**	(119)
Unrecognized actuarial losses	176	**278**	149
Unrecognized past service costs	7	**11**	12
Net amount recognized in the Consolidated Balance Sheets	46	**72**	42
Accrued benefit asset – defined benefit plans	72	**114**	88
Accrued benefit liability – defined benefit plans	(26)	**(42)**	(46)
Net amount recognized in the Consolidated Balance Sheets	46	**72**	42

Weighted-average assumptions	2002	2001	2000
Discount rate	**6.6%**	6.7%	7.0%
Expected return on plan assets	**8.2%**	8.2%	8.2%
Rate of compensation increase	**3.9%**	3.9%	3.5%

Effective January 1, 2003, Domtar will use 7.7% as the expected return on plan assets, which reflects the current view of long-term investment returns.

As at December 31, 2002, the accrued benefit obligation and the fair value of defined benefit plan assets for the pension plans with an accrued benefit obligation in excess of fair value plan assets were $1,000 million and $787 million (2001 – $936 million and $814 million), respectively.

Note 22

Other employee future benefit plans

The post-retirement and post-employment plans are unfunded. Only certain long-term disability plans, which were settled in 2001, were funded.

Components of net periodic benefit cost for other employee future benefit plans	2002 US$ (Note 3)	**2002 $**	2001 $	2000 $
Service cost for the year	3	**4**	3	4
Interest expense	4	**7**	6	5
Actuarial losses	1	**1**	1	–
Settlement loss	–	**–**	2	–
Net periodic benefit cost for other employee future benefit plans	8	**12**	12	9

Change in accrued benefit obligation for other employee future benefit plans	2002 US$ (Note 3)	**2002 $**	2001 $
Accrued benefit obligation at beginning of year	66	**104**	98
Service cost for the year	2	**4**	3
Interest expense	4	**7**	6
Actuarial losses	1	**1**	4
Settlement	–	**–**	(7)
Acquisitions	–	**–**	6
Benefits paid	(4)	**(7)**	(7)
Effect of foreign currency exchange rate changes	–	**–**	1
Accrued benefit obligation at end of year	69	**109**	104

Change in assets of other employee future benefit plans	2002 US$ (Note 3)	**2002 $**	2001 $
Fair value of assets of other employee future benefit plans at beginning of year	–	**–**	9
Employer contributions	4	**7**	7
Benefits paid	(4)	**(7)**	(7)
Settlement	–	**–**	(9)
Fair value of assets of other employee future benefit plans at end of year	–	**–**	–

Notes to consolidated financial statements — December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 22 (continued)

Funded status and net amount recognized in the Consolidated Balance Sheets	2002 US$ (Note 3)	**2002 $**	2001 $
Funded status	69	**109**	104
Unrecognized actuarial losses	(13)	**(20)**	(19)
Net amount recognized in the Consolidated Balance Sheets	56	**89**	85

In 2001, Domtar settled its long-term disability obligations through the purchase of an insurance contract by which the insurer assumes all of the risks and obligations under the plans, resulting in a settlement loss of $2 million.

Weighted-average assumptions	**2002**	2001	2000
Discount rate	**6.6%**	6.7%	7.1%
Rate of compensation increase	**4.3%**	3.7%	3.5%

For measurement purposes, 8.6% weighted-average annual rate of increase in the per capita cost of covered health care benefits was assumed for 2003. The rate was assumed to decrease gradually to 4.1% for 2009 and remain at that level thereafter. An increase or decrease of 1% of this rate would have the following impact:

	Increase of 1%		Decrease of 1%	
	US$ (Note 3)	$	US$ (Note 3)	$
Impact on net periodic benefit cost	1	1	(1)	(1)
Impact on accrued benefit obligation	5	8	(4)	(6)

Note 23

Segmented disclosures

Domtar operates in the four reportable segments described below. Each reportable segment offers different products and services and requires different technology and marketing strategies. The following summary briefly describes the operations included in each of Domtar's reportable segments:

Papers – represents the aggregation of the manufacturing and distribution of business, commercial printing and publication, and technical and specialty papers, as well as pulp.

Paper Merchants – involves the purchasing, warehousing, sale and distribution of various products made by Domtar as well as by other manufacturers. These products include business and printing papers, graphic arts supplies and certain industrial products.

Wood – comprises the manufacture and marketing of lumber and wood-based value-added products as well as the management of forest resources.

Packaging – comprises the Corporation's 50% ownership interest in Norampac, a company that manufactures and distributes containerboard and corrugated products.

The accounting policies of the reportable segments are the same as those described in Note 1. Domtar evaluates performance based on operating profit, which represents sales, reflecting transfer prices between segments at fair value, less allocable expenses before financing expenses and income taxes. Segment assets are those directly used in segment operations.

Segmented data	2002 US$ (Note 3)	**2002 $**	2001 $	2000 $
Net sales				
Papers	2,245	**3,546**	2,541	2,063
Paper Merchants	755	**1,193**	1,188	714
Wood [(a)]	363	**574**	491	554
Packaging	385	**608**	551	536
Total for reportable segments	3,748	**5,921**	4,771	3,867
Intersegment sales – Papers	(197)	**(312)**	(304)	(179)
Intersegment sales – Wood	(71)	**(112)**	(81)	(78)
Intersegment sales – Packaging	(4)	**(7)**	(9)	(12)
Consolidated net sales	3,476	**5,490**	4,377	3,598
Amortization				
Papers [(b)]	212	**335**	227	175
Paper Merchants	2	**3**	4	3
Wood [(c)]	32	**51**	32	33
Packaging	21	**32**	28	26
Total for reportable segments	267	**421**	291	237
Corporate	2	**4**	3	2
Consolidated amortization	269	**425**	294	239
Operating profit (loss)				
Papers [(b)(d)]	190	**301**	246	395
Paper Merchants	16	**25**	17	13
Wood [(a)(c)]	(10)	**(16)**	(46)	(33)
Packaging	47	**74**	82	100
Total for reportable segments	243	**384**	299	475
Corporate [(e)]	–	**–**	14	1
Consolidated operating profit	243	**384**	313	476

	2002 US$ (Note 3)	**2002 $**	2001 Restated (Note 2) $	2000 Restated (Note 2) $
Segment assets				
Papers	3,265	**5,157**	5,400	2,718
Paper Merchants	125	**198**	208	293
Wood	351	**554**	563	534
Packaging	417	**658**	626	553
Total for reportable segments	4,158	**6,567**	6,797	4,098
Corporate	177	**280**	258	137
Consolidated assets	4,335	**6,847**	7,055	4,235

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 23 (continued)

	2002 US$ (Note 3)	2002 $	2001 $	2000 $
Net additions to property, plant and equipment				
Papers	86	**136**	154	150
Paper Merchants	1	**2**	4	2
Wood	30	**48**	67	53
Packaging	20	**31**	47	41
Total for reportable segments	137	**217**	272	246
Corporate	6	**9**	12	6
Disposals of property, plant and equipment	(2)	**(3)**	(4)	(4)
Consolidated net additions to property, plant and equipment	141	**223**	280	248
Geographic information				
Net sales (a) (f) (g)				
Canada	819	**1,294**	1,241	1,364
United States	2,516	**3,974**	3,019	2,157
Other foreign countries	141	**222**	117	77
	3,476	**5,490**	4,377	3,598
Property, plant, equipment and goodwill				
Canada	1,784	**2,818**	2,951	2,914
United States	1,657	**2,618**	2,696	134
Other foreign countries	19	**30**	27	19
	3,460	**5,466**	5,674	3,067

(a) The net sales and the operating profit for the year ended December 31, 2002 reflect a reversal of a $20 million provision recorded in year ended December 31, 2001 for countervailing and antidumping duties on exports of softwood lumber to the United States.

(b) The operating profit for the year ended December 31, 2002 reflects a $45 million charge, including $14 million related to the write down of property, plant and equipment, relating to the permanent shutdown of the St. Catharines, Ontario paper mill.

(c) The operating profit for the year ended December 31, 2002 reflects an $18 million charge, including $13 million related to the write down of property, plant and equipment, relating to the shutdown of the Sault Ste. Marie hardwood lumber operations and the Daveluyville, Québec wood products remanufacturing facility.

(d) The operating profit for the year ended December 31, 2002 includes the recognition of $16 million for investment tax credits related to research and development expenses of prior years, reflected as a reduction of the cost of sales.

(e) The operating profit for the year ended December 31, 2001 includes $14 million primarily related to the cashing in of certain insurance policies.

(f) Sales are attributed to countries based on location of external customer.

(g) In 2002, export sales from Canada were $1,592 million (2001 – $1,635 million; 2000 – $1,658 million).

Note 24

Reconciliation of Canadian and United States Generally Accepted Accounting Principles

The Consolidated Earnings and the Consolidated Balance Sheets have been prepared in accordance with Canadian GAAP which differ in some respects from U.S. GAAP. The following are the significant differences in accounting principles as they pertain to the Consolidated Earnings and the Consolidated Balance Sheets.

(a) Net earnings adjustments

The following table provides a reconciliation of the net earnings under Canadian GAAP to U.S. GAAP.

	2002	2002	2001	2000
			Restated (1 & 4)	Restated (4)
	US$ (Note 3)	**$**	$	$
Net earnings in accordance with Canadian GAAP	89	**141**	140	262
Adjustments with respect to the following items:				
Pension plans cost [2]	(5)	**(8)**	(2)	(6)
Other employee future benefit plans cost [3]	–	**–**	1	–
Revenue streams hedge [5]	1	**2**	–	–
Foreign currency hedging contracts [6]	42	**67**	(51)	(73)
Commodity hedging contracts [7]	–	**–**	1	–
Interest rate swap contracts [8]	39	**62**	(19)	–
Share of joint ventures' U.S. GAAP adjustments [9]	–	**(1)**	1	–
Amortization of deferred gain [9]	(3)	**(5)**	(5)	(5)
Acquisition of E.B. Eddy [10]	(4)	**(6)**	(11)	(13)
Formation of Norampac [11]	(1)	**(2)**	(2)	(2)
Loss from discontinued operations [12]	32	**50**	3	7
Tax effect of the above adjustments	(31)	**(49)**	30	31
Earnings from continuing operations in accordance with U.S. GAAP	159	**251**	86	201
Loss from discontinued operations net of income taxes [12]	(21)	**(33)**	(2)	(5)
Net earnings in accordance with U.S. GAAP	138	**218**	84	196
Dividend requirements of preferred shares	–	**1**	2	3
Net earnings applicable to common shares in accordance with U.S. GAAP	138	**217**	82	193
Earnings from continuing operations per common share in accordance with U.S. GAAP				
Basic	0.70	**1.10**	0.44	1.08
Diluted	0.70	**1.10**	0.44	1.08
Net earnings per common share in accordance with U.S. GAAP				
Basic	0.61	**0.96**	0.43	1.06
Diluted	0.60	**0.95**	0.43	1.05

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 24 (continued)

The following table presents the Consolidated Earnings under Canadian and U.S. GAAP.

	2002	2002	**2002**	**2002**	2001	2001	2000	2000
					Restated (Note 2)	Restated (1)	Restated (Note 2)	
	US$ (Note 3) Canadian GAAP	US$ (Note 3) U.S. GAAP	**$ Canadian GAAP**	**$ U.S. GAAP**	$ Canadian GAAP	$ U.S. GAAP	$ Canadian GAAP	$ U.S. GAAP
Net sales	3,476	3,274	**5,490**	**5,172**	4,377	4,012	3,598	3,197
Operating expenses								
Cost of sales	2,736	2,642	**4,321**	**4,174**	3,514	3,301	2,703	2,457
Selling, general and administrative	205	175	**324**	**276**	256	215	180	151
Amortization	252	236	**398**	**372**	294	274	239	225
Closure costs	40	11	**63**	**18**	–	–	–	–
	3,233	3,064	**5,106**	**4,840**	4,064	3,790	3,122	2,833
Operating profit	243	210	**384**	**332**	313	222	476	364
Financing expenses	(121)	(109)	**(192)**	**(172)**	(167)	(144)	(119)	(97)
Amortization of deferred gain	3	–	**5**	**–**	5	–	5	–
Share of joint ventures' net earnings (9 & 11)	–	23	**–**	**34**	–	40	–	50
Derivative instruments gain (loss) (6 to 8)	–	81	**–**	**129**	–	(69)	–	(73)
	125	205	**197**	**323**	151	49	362	244
Income tax expense (recovery)	36	46	**56**	**72**	11	(37)	100	43
Earnings from continuing operations	89	159	**141**	**251**	140	86	262	201
Loss from discontinued operations net of income taxes (12)	–	21	**–**	**33**	–	2	–	5
Net earnings	89	138	**141**	**218**	140	84	262	196
Dividend requirements of preferred shares	–	–	**1**	**1**	2	2	3	3
Net earnings applicable to common shares	89	138	**140**	**217**	138	82	259	193
Earnings from continuing operations per common shares								
Basic	0.39	0.70	**0.62**	**1.10**	0.72	0.44	1.42	1.08
Diluted	0.39	0.70	**0.61**	**1.10**	0.72	0.44	1.41	1.08
Net earnings per common shares								
Basic	0.39	0.61	**0.62**	**0.96**	0.72	0.43	1.42	1.06
Diluted	0.39	0.60	**0.61**	**0.95**	0.72	0.43	1.41	1.05

See section (e) for the reconciliation of the Consolidated Earnings items.

(b) Balance sheet adjustments

The following table presents the Consolidated Balance Sheets under Canadian GAAP and U.S. GAAP.

	2002	2002	2002	2002	2001	2001
					Restated (Note 2)	Restated (1)
	US$ (Note 3) Canadian GAAP	US$ (Note 3) U.S. GAAP	$ Canadian GAAP	$ U.S. GAAP	$ Canadian GAAP	$ U.S. GAAP
Asset						
Current assets						
Cash and cash equivalents	24	15	**38**	**24**	36	29
Receivables	193	141	**304**	**222**	300	215
Inventories	466	424	**736**	**670**	779	717
Prepaid expenses	14	13	**22**	**20**	24	22
Future income taxes	48	48	**76**	**76**	29	29
	745	641	**1,176**	**1,012**	1,168	1,012
Property, plant and equipment	3,410	3,215	**5,387**	**5,079**	5,612	5,322
Goodwill	50	68	**79**	**108**	62	108
Other assets	130	273	**205**	**431**	213	372
	4,335	4,197	**6,847**	**6,630**	7,055	6,814
Liabilities and shareholders' equity						
Current liabilities						
Bank indebtedness	13	10	**20**	**15**	45	35
Trade and other payables	474	436	**749**	**690**	708	725
Income and other taxes payable	10	6	**15**	**10**	19	9
Long-term debt due within one year	44	32	**70**	**50**	38	37
	541	484	**854**	**765**	810	806
Long-term debt	1,547	1,427	**2,444**	**2,254**	2,883	2,684
Future income taxes	396	348	**625**	**549**	528	443
Other liabilities and deferred credits	234	248	**370**	**392**	408	381
Shareholders' equity						
Preferred shares	28	28	**44**	**44**	48	48
Common shares	1,109	1,102	**1,752**	**1,741**	1,731	1,723
Contributed surplus	2	2	**3**	**3**	–	–
Retained earnings	477	580	**753**	**916**	645	731
Accumulated foreign currency translation adjustments	1	–	**2**	**–**	2	–
Accumulated other comprehensive income	–	(22)	**–**	**(34)**	–	(2)
	1,617	1,690	**2,554**	**2,670**	2,426	2,500
	4,335	4,197	**6,847**	**6,630**	7,055	6,814

See section (f) for the reconciliation of the Consolidated Balance Sheets items.

Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 24 (continued)

(c) Differences between Canadian GAAP and U.S. GAAP

(1) Restatement of 2001 financial statements

In 2002, the Corporation concluded that, in 2001, it did not meet all of the hedge accounting criteria in SFAS 133 for the Corporation's interest rate swap contracts, notwithstanding that these instruments were designated as hedges and highly effective in achieving their intended purpose from an economic point of view. Consequently, the Corporation has restated the 2001 U.S. GAAP financial statments. "Derivative instruments loss" was increased by $19 million ($13 million net of income tax or $0.07 per common share (basic and diluted)) and "Comprehensive income" was decreased by $13 million. "Long-term debt" was increased by $19 million; "Future income taxes" was decreased by $6 million; and "Shareholders' equity" was decreased by $13 million.

(2) Pension plans cost

On January 1, 2000, Domtar adopted the Canadian accounting recommendations for employee future benefit costs (Note 2). The recommendations essentially harmonize Canadian GAAP with U.S. GAAP and were applied retroactively without restating prior years. Differences between Canadian and U.S. GAAP remain with respect to the amortization of actuarial gains and losses and past service costs arising prior to January 1, 2000. Differences also arise from the fact that the straight-line method is used to amortize actuarial gains and losses for U.S. GAAP purposes while the corridor method is used for Canadian GAAP purposes.

Furthermore, under U.S. GAAP, an additional minimum pension liability is recorded for plans where the accumulated benefit obligation exceeds the fair value of plan assets. For these plans, an intangible asset is recorded up to the extent of unrecognized past service costs. The balance is recorded in "Other comprehensive income", net of applicable income taxes. The concept of additional minimum liability does not exist under Canadian GAAP.

(3) Other employee future benefit plans cost

On January 1, 2000, Domtar adopted the Canadian accounting recommendations for employee future benefit costs (Note 2). The recommendations essentially harmonize Canadian GAAP with U.S. GAAP and were applied retroactively without restating prior years. Differences between Canadian and U.S. GAAP remain with respect to the amortization of actuarial gains and losses arising prior to January 1, 2000.

(4) Translation of long-term debt

On January 1, 2002, Domtar adopted the Canadian accounting recommendations relating to the accounting for foreign currency translation (Note 2). These recommendations eliminate the requirement to defer and amortize unrealized exchange gains and losses on foreign currency denominated monetary items that have a fixed or ascertainable life extending beyond the end of the fiscal year following the current reporting period.
The recommendations essentially harmonize Canadian GAAP with U.S. GAAP and were applied retroactively with restatement of prior years.

(5) Revenue streams hedge

In connection with the adoption of the Canadian accounting recommendations relating to the accounting for foreign currency translation (Note 2), the Corporation has elected to designate certain U.S. dollar denominated debt as a hedge of its U.S. dollar revenue streams. The exchange gain deferred under Canadian GAAP is recorded to earnings under U.S. GAAP, as such designation is not possible under U.S. GAAP.

(6) Currency hedging contracts

Under Canadian GAAP, unrealized gains and losses on currency hedging contracts are included in earnings when the revenue is recognized. With the adoption of SFAS 133 and 138 mentioned under (d)(i) below, Domtar has elected not to designate the contracts as hedging instruments for U.S. GAAP reporting purposes. Accordingly, these contracts are marked to market and resulting unrealized gains and losses are recorded to earnings. Prior to January 1, 2001, under U.S. GAAP, these contracts did not qualify as hedging instruments and accordingly were marked to market, and the resulting unrealized gains and losses were recorded to earnings. Under Canadian GAAP, gains and losses related to these contracts are included in "Net sales".

(7) Commodity hedging contracts

Under Canadian GAAP, gains and losses on commodity hedging contracts are included in earnings when the designated transaction is recognized. With the adoption of SFAS 133 and 138 mentioned under (d)(i) below, Domtar has elected to not designate these contracts as hedging instruments for U.S. GAAP reporting purposes. Accordingly, these contracts are marked to market and the resulting unrealized gains and losses are recorded to earnings. Under Canadian GAAP, gains and losses related to these contracts are included in "Net sales".

(8) Interest rate swap contracts

Under Canadian GAAP, unrealized gains and losses on interest rate swap contracts designated as hedges are not recognized in the financial statements. Under U.S. GAAP, these interest rate swap contracts cannot be designated as a hedge and are marked to market. Therefore, any fluctuations of the fair value are recorded to earnings. Accordingly, the $19 million (US$12 million) unrealized loss as at December 31, 2001, was recorded to earnings with the offsetting amount being recorded under "Other liabilities and deferred credits".

In November 2002, the Corporation terminated prior to maturity its interest rate swap contracts for net cash proceed of $40 million (US$26 million). Under Canadian GAAP, this net gain is deferred and recognized as a deduction of "Financing expenses" over the period of the interest rate payments initially designated as being hedged by these swaps. Furthermore, the Corporation had an unamortized deferred credit of $3 million related to interest received under these contracts during the year. Under U.S. GAAP, there is no deferred amount as the fluctuations in the swaps' market value and interest payments are recognized in earnings as they arise.

(9) Joint ventures

Interest in joint ventures is accounted for using the proportionate consolidation method for Canadian GAAP and using the equity method under U.S. GAAP. This difference does not affect "Net earnings" or "Shareholders' equity". Furthermore, under Canadian GAAP, a portion of the gain on the contribution to Norampac is deferred and amortized. Under U.S. GAAP, this gain was fully recognized upon the formation of Norampac.

(10) Acquisition of E.B. Eddy

The E.B. Eddy acquisition has been accounted for under Canadian GAAP which, at the time, differed from U.S. GAAP in the accounting for income taxes, pension benefits and accounting for business integration provisions.

(11) Formation of Norampac

On January 1, 2000, Domtar adopted the Canadian accounting recommendations for income taxes (Note 2). These recommendations essentially harmonize Canadian and U.S. GAAP and were applied retroactively without restating prior years. Accordingly, certain property, plant and equipment acquired at the formation of Norampac remained recorded at a lower value under Canadian GAAP. Under U.S. GAAP, as at December 31, 2002, "Property, plant and equipment" as well as "Retained earnings" were increased by $24 million (2001 - $26 million).

(12) Loss from discontinued operations

On January 1, 2002, Domtar adopted SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" for reporting purposes under U.S GAAP. SFAS 144 establishes an accounting model to be used for long-lived assets to be disposed of by sale and broadens the presentation of discontinued operations to include more disposal transactions. Pursuant to SFAS 144, Domtar's closure of its St. Catharines paper mill, which occured during the year ended December 31, 2002, qualifies as a discontinued operation.

(13) Net sales

Net sales for 2002 included deductions amounting to $31 million and a reversal of a $20 million provision recorded in 2001 for countervailing and antidumping duties on exports of softwood lumber to the United States. Net sales also included delivery costs as described in Note 1. Both the countervailing and antidumping duties as well as delivery costs have been reclassified in Cost of sales under U.S. GAAP.

(14) Investment tax credits

Under U.S. GAAP, the income tax expense has been reduced by $16 million for investment tax credits related to research and development expenses of prior years which had been recognized as a reduction of cost of sales under Canadian GAAP.

Note 24 (continued)

(15) Long-term debt discount

Under Canadian GAAP, long-term debt discount is presented in "Other assets" as a deferred charge. U.S. GAAP requires that long-term debt discount be reported as a direct reduction of the long-term debt.

(16) Share purchase loans receivable

Under U.S. GAAP, share purchase loans receivable should be presented as deductions from "Common shares" unless there is substantial evidence that the borrower, not the enterprise, is at risk for any decline in the price of the shares and there is reasonable assurance that the enterprise will collect the full amount of the loan in cash. Domtar does not meet the criteria because these receivables are guaranteed by the shares issued.

(d) Supplementary disclosures

i) Accounting changes

Stock-based compensation and other stock-based payments

On January 1, 2002, and concurrently with the adoption of Section 3870 "Stock-based compensation and other stock-based payments" for Canadian GAAP purposes, Domtar adopted the fair value method defined in SFAS 123 to measure its stock-based compensation and other stock-based payments (Note 2). SFAS 123 indicates that the fair value method is the preferable method of accounting and requires that the fair value method be adopted prospectively.

Prior to January 1, 2002, Domtar had elected to measure stock-based compensation and other stock-based payments using the intrinsic value base method of accounting. In this instance, however, under SFAS 123, Domtar is required to make pro forma disclosures of net earnings, basic earnings per share and diluted earnings per share using the fair value method of accounting for stock-based compensation and other stock-based payments granted prior to January 1, 2002.

Accordingly, Domtar's net earnings, basic earnings per share and diluted earnings per share for the year ended December 31, 2002 would have been reduced, on a pro forma basis, by $3 million, $0.01 per common share and $0.01 per common share, respectively (2001 — $3 million, $0.02 per common share and $0.02 per common share, respectively; 2000 — $2 million, $0.01 per common share and $0.01 per common share, respectively) for stock-based compensation and other stock-based payments granted prior to January 1, 2002.

Goodwill and intangible assets

On January 1, 2002, and concurrently with the adoption of Section 3062 "Goodwill and intangible assets" for Canadian purposes, Domtar has adopted SFAS 142 "Goodwill and Other Intangible Assets" (Note 2). SFAS 142 requires that goodwill be tested for impairment and prohibits the amortization of goodwill. Under U.S. GAAP, as at December 31, 2002, Domtar had goodwill of $102 million arising from the acquisition of E.B. Eddy (see (c) (10) above) in addition to the goodwill under Canadian GAAP. Amortization thereof amounted to $6 million during the years 2001 and 2000. Pursuant to SFAS 142, Domtar has tested its goodwill for impairment and has determined that no write down for impairment was necessary.

Derivative instruments and hedging activities

Effective January 1, 2001, Domtar adopted SFAS 133 "Accounting for Derivative Instruments and Hedging Activities" and SFAS 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities". These standards require all derivative financial instruments to be recorded on the balance sheet at their fair value. Changes in fair value of derivatives that are not hedges are recognized in the earnings as they arise. If the derivative is a hedge, depending on the nature of the hedge, a change in the fair value of the derivative is either offset in income against the change in the fair value of the hedged asset, liability or firm commitment or is recognized in "Other comprehensive income" until the hedged item is recognized in earnings. In adopting these standards, Domtar incurred a transition adjustment of $1 million resulting from the net unrealized loss on commodity hedging contracts. As these contracts constituted cash flow hedges, this transitional adjustment had been recorded in "Other comprehensive income" in 2001 and was transferred to earnings during the year as the contracts matured.

ii) Defined benefit pension plans

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for the pension plans with accumulated benefit obligations in excess of plan assets were $997 million, $904 million and $785 million, respectively, as at December 31, 2002 and $148 million, $134 million and $87 million, respectively, as at December 31, 2001.

iii) Comprehensive income and accumulated other comprehensive income

Comprehensive income	2002	2002	2001	2000
			Restated (1)	
	US$ (Note 3)	$	$	$
Net earnings in accordance with U.S. GAAP	138	**218**	84	196
Other comprehensive income				
Additional minimum liability of defined benefit pension plans, net of income taxes of $19 million (2001 — nil; 2000 — $(1) million) (see (c)(2) above))	(21)	**(33)**	(1)	1
Cumulative effect of adopting SFAS 133 and 138 (see (i) above)	–	**–**	(1)	–
Transfer of unrealized loss on commodity hedging contracts to earnings	1	**1**	–	–
Foreign currency translation adjustments	–	**–**	3	–
Comprehensive income	118	**186**	85	197

Accumulated other comprehensive income	2002	2002	2001	2000
	US$ (Note 3)	$	$	$
Additional minimum liability of defined benefit pension plans	(23)	**(36)**	(3)	(2)
Unrealized loss on commodity hedging contracts	–	**–**	(1)	–
Foreign currency translation adjustments	1	**2**	2	(1)
Accumulated other comprehensive income	(22)	**(34)**	(2)	(3)

Notes to consolidated financial statements — December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 24 (continued)

iv) Impact of accounting pronouncements not yet implemented

Costs associated with exit or disposal activities

In June 2002, the FASB issued SFAS 146 "Accounting for Costs Associated with Exit or Disposal Activities" which requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when a liability is incurred. Domtar will adopt SFAS 146 on January 1, 2003 for U.S. GAAP reporting. Domtar does not anticipate any immediate financial statement impact with the adoption of this standard.

Asset retirement obligations

In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations". Domtar must adopt this standard for U.S. GAAP reporting at the beginning of fiscal year 2003. This standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. Domtar is currently assessing the impact that this standard will have on its results of operations and financial position.

Guarantees

In November 2002, the FASB issued interpretation FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", which requires that a guarantor disclose and recognize in its financial statements its obligations relating to guarantees that it has issued. Liability recognition is required at the inception of the guarantee, whether or not payment is probable. The disclosure requirements are effective for periods ending after December 15, 2002 and have been reflected in the financial statements. The recognition and measurement provisions are effective for guarantees issued or modified after December 31, 2002.

Variable interest entities

In January 2003, the FASB issued interpretation FIN No. 46, "Consolidation of Variable Interest Entities" which requires that an enterprise holding a variable interest in a Variable Interest Entity (VIE) could, subject to certain conditions, be required to consolidate the VIE if the enterprise is to absorb a majority of the VIE's expected losses and/or receive a majority of its expected residual returns. This interpretation is effective for newly created VIEs after January 31, 2003. For VIEs existing prior to this date, the provisions of the interpretation are effective for reporting periods beginning after June 15, 2003. Domtar does not expect the recommendation to have an initial impact on its financial statements upon adoption.

(e) Reconciliation of the Consolidated Earnings items from Canadian GAAP to U.S. GAAP

	2002 US$ (Note 3)	2002 $	2001 $	2000 $
Net sales – Canadian GAAP	3,476	**5,490**	4,377	3,598
Discontinued operations (12)	(22)	**(34)**	(58)	(51)
Delivery costs (13)	195	**308**	215	174
Countervailling and antidumping duties (13)	7	**11**	20	–
Joint ventures (9)	(382)	**(603)**	(542)	(524)
Net sales – U.S. GAAP	3,274	**5,172**	4,012	3,197
Cost of sales – Canadian GAAP	2,736	**4,321**	3,514	2,703
Pension plans cost (2)	5	**8**	2	6
Other employee future benefit plans cost (3)	–	**–**	(1)	–
Discontinued operations (12)	(25)	**(39)**	(59)	(57)
Delivery costs (13)	195	**308**	215	174
Countervailling and antidumping duties (13)	7	**11**	20	–
Investment tax credits (14)	10	**16**	–	–
Joint ventures (9)	(286)	**(451)**	(390)	(369)
Cost of sales – U.S. GAAP	2,642	**4,174**	3,301	2,457
Selling, general and administrative – Canadian GAAP	205	**324**	256	180
Joint ventures (9)	(30)	**(48)**	(41)	(29)
Selling, general and administrative – U.S. GAAP	175	**276**	215	151
Amortization – Canadian GAAP	252	**398**	294	239
Acquisition of E.B. Eddy (10)	4	**6**	11	13
Discontinued operations (12)	–	**–**	(2)	(1)
Joint ventures (9)	(20)	**(32)**	(29)	(26)
Amortization – U.S. GAAP	236	**372**	274	225
Closure costs – Canadian GAAP	40	**63**	–	–
Discontinued operations (12)	(29)	**(45)**	–	–
Closure costs – U.S. GAAP	11	**18**	–	–

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 24 (continued)

(e) Reconciliation of the Consolidated Earnings items from Canadian GAAP to U.S. GAAP (continued)

	2002 US$ (Note 3)	2002 $	2001 $	2000 $
Financing expenses – Canadian GAAP	121	**192**	167	119
Revenue streams hedge [5]	(1)	**(2)**	–	–
Joint ventures [9]	(11)	**(18)**	(23)	(22)
Financing expenses – U.S. GAAP	109	**172**	144	97
Income tax expense – Canadian GAAP	36	**56**	11	100
Tax effect of the adjustments	31	**49**	(30)	(31)
Investment tax credits [14]	(10)	**(16)**	–	–
Joint ventures [9]	(11)	**(17)**	(18)	(26)
Income tax expense – U.S. GAAP	46	**72**	(37)	43

(f) Reconciliation of the Consolidated Balance Sheets items from Canadian GAAP to U.S. GAAP

	2002 US$ (Note 3)	2002 $	2001 $
Cash and cash equivalents – Canadian GAAP	24	**38**	36
Joint ventures [9]	(9)	**(14)**	(7)
Cash and cash equivalents – U.S. GAAP	15	**24**	29
Receivables – Canadian GAAP	193	**304**	300
Joint ventures [9]	(52)	**(82)**	(85)
Receivables – U.S. GAAP	141	**222**	215
Inventories – Canadian GAAP	466	**736**	779
Joint ventures [9]	(42)	**(66)**	(62)
Inventories – U.S. GAAP	424	**670**	717
Prepaid expenses – Canadian GAAP	14	**22**	24
Joint ventures [9]	(1)	**(2)**	(2)
Prepaid expenses – U.S. GAAP	13	**20**	22
Property, plant and equipment – Canadian GAAP	3,410	**5,387**	5,612
Acquistion of E.B. Eddy [10]	50	**79**	85
Joint ventures [9 & 11]	(245)	**(387)**	(375)
Property, plant and equipment – U.S. GAAP	3,215	**5,079**	5,322
Goodwill – Canadian GAAP	50	**79**	62
Acquistion of E.B. Eddy [10]	64	**102**	102
Joint ventures [9]	(46)	**(73)**	(56)
Goodwill – U.S. GAAP	68	**108**	108

	2002 US$ (Note 3)	**2002** **$**	2001 $
Other assets — Canadian GAAP	130	**205**	213
Pension plans cost (2)	(49)	**(77)**	(70)
Additional minimum liability (2)	38	**60**	4
Commodity hedging contracts (7)	1	**1**	—
Long-term debt discount (15)	(7)	**(11)**	(12)
Share purchase loans receivable (16)	(7)	**(11)**	(8)
Joint ventures (9)	167	**264**	245
Other assets — U.S. GAAP	273	**431**	372
Bank indebtedness — Canadian GAAP	13	**20**	45
Joint ventures (9)	(3)	**(5)**	(10)
Bank indebtedness — U.S. GAAP	10	**15**	35
Trade and other payables — Canadian GAAP	474	**749**	708
Foreign currency hedging contracts (6)	17	**27**	94
Joint ventures (9)	(55)	**(86)**	(77)
Trade and other payables — U.S. GAAP	436	**690**	725
Income and other taxes payable — Canadian GAAP	10	**15**	19
Joint ventures (9)	(4)	**(5)**	(10)
Income and other taxes payable — U.S. GAAP	6	**10**	9
Long-term debt due within one year — Canadian GAAP	44	**70**	38
Joint ventures (9)	(12)	**(20)**	(1)
Long-term debt due within one year — U.S. GAAP	32	**50**	37
Long-term debt — Canadian GAAP	1,547	**2,444**	2,883
Long-term debt discount (15)	(7)	**(11)**	(12)
Joint ventures (9)	(113)	**(179)**	(187)
Long-term debt — U.S. GAAP	1,427	**2,254**	2,684

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Notes to consolidated financial statements – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Note 24 (continued)

(f) Reconciliation of the Consolidated Balance Sheets items from Canadian GAAP to U.S. GAAP (continued)

	2002 US$ (Note 3)	2002 $	2001 $
Future income taxes – Canadian GAAP	396	**625**	528
Tax effect of the adjustments	(3)	**(5)**	(18)
Joint ventures [9]	(45)	**(71)**	(67)
Future income taxes – U.S. GAAP	348	**549**	443
Other liabilities and deferred credits – Canadian GAAP	234	**370**	408
Pension plans cost [2]	(2)	**(3)**	(4)
Additional minimum liability [2]	73	**116**	8
Other employee future benefit plans cost [3]	13	**20**	20
Revenue streams hedge [5]	(1)	**(2)**	–
Interest rate swap contracts [8]	(27)	**(43)**	19
Deferred gain on contribution of net assets to Norampac [9]	(30)	**(48)**	(53)
Joint ventures [9]	(12)	**(18)**	(17)
Other liabilities and deferred credits – U.S. GAAP	248	**392**	381
Common shares – Canadian GAAP	1,109	**1,752**	1,731
Share purchase loans receivable [16]	(7)	**(11)**	(8)
Common shares – U.S. GAAP	1,102	**1,741**	1,723
Retained earnings – Canadian GAAP	477	**753**	645
Pension plans cost [2]	(32)	**(50)**	(45)
Other employee future benefit plans cost [3]	(9)	**(14)**	(14)
Revenue streams hedge [5]	1	**1**	–
Foreign currency hedging contracts [6]	(13)	**(21)**	(68)
Commodity hedging contracts [7]	1	**1**	–
Interest rate swap contracts [8]	18	**30**	(13)
Deferred gain on contribution of net assets to Norampac [9]	23	**36**	37
Acquistion of E.B. Eddy [10]	99	**156**	161
Joint ventures [9 & 11]	15	**24**	28
Retained earnings – U.S. GAAP	580	**916**	731
Accumulated foreign currency translation adjustments – Canadian GAAP	1	**2**	2
Additional minimum liability [2]	(23)	**(36)**	(3)
Unrealized loss on commodity hedging contracts	–	**–**	(1)
Accumulated other comprehensive income – U.S. GAAP	(22)	**(34)**	(2)

Note 25

Comparative figures

To conform with the basis of presentation adopted in the current year, certain figures previously reported have been reclassified.

Supplementary information – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Supplementary information

Economic value added (EVA®)

In addition to using return on equity as an important financial metric, Domtar also uses EVA® to ensure that its decision-making processes are aligned with the objective of increasing shareholder value. EVA® is used at Domtar to measure performance and to evaluate investment decisions.

EVA® is positive when a company's net after-tax operating profit exceeds a capital charge representing the return expected by the providers of the company's capital. Domtar reviews its cost of capital periodically, based on changes in financial markets.

Domtar's EVA® for 2002 amounted to negative $124 million, improving slightly by $5 million over 2001, mainly due to our quality and profitability improvement programs and the favorable effect of a stronger U.S. dollar, partially offset by lower selling prices.

During 2003, Domtar expects to reap the full benefits of its quality and profitability improvement programs. Domtar remains committed to providing superior shareholder value and will continue to exercise financial discipline, especially with respect to capital management.

EVA® is a registered trademark of Stern Stewart & Co.

Return on Domtar Stock
(Value of $100 invested on January 1st, 1996)

Common stock prices

Quarterly share prices for the common shares of Domtar during 2002 and 2001 were as follows:

	1st	2nd	3rd	4th
	$	$	$	$
Market price – 2002				
Toronto Stock Exchange				
High	**18.99**	**18.70**	**18.50**	**17.80**
Low	**14.80**	**16.30**	**13.50**	**13.83**
New York Stock Exchange (US$)				
High	**12.00**	**12.33**	**12.08**	**11.39**
Low	**9.27**	**10.32**	**8.61**	**8.60**
Market price – 2001				
Toronto Stock Exchange				
High	14.80	16.46	15.65	16.15
Low	11.00	12.95	11.51	11.15
New York Stock Exchange (US$)				
High	9.49	10.71	10.12	10.16
Low	7.44	8.52	7.34	6.80

Quarterly financial information (unaudited)

	1st	2nd	3rd	4th	Year
	$	$	$	$	$
2002					
Net sales	**1,328**	**1,416**	**1,390**	**1,356**	**5,490**
Operating profit	**32**	**118**	**136**	**98**	**384**
Net earnings	**(11)**	**55**	**59**	**38**	**141**
Cash flows provided from operating activities	**1**	**257**	**169**	**250**	**677**
Net additions to property, plant and equipment	**38**	**44**	**46**	**95**	**223**
EBITDA	**142**	**217**	**233**	**217**	**809**
Per common share					
Net earnings					
Basic	**(0.05)**	**0.24**	**0.26**	**0.17**	**0.62**
Diluted	**(0.05)**	**0.24**	**0.26**	**0.17**	**0.61**

	1st	2nd	3rd	4th	Year
	$	$	$	$	$
2001					
Net sales	954	944	1,177	1,302	4,377
Operating profit	78	88	83	64	313
Net earnings	21	87	14	18	140
Cash flows provided from (used for) operating activities	(5)	143	153	436	727
Net additions to property, plant and equipment	58	60	82	80	280
EBITDA	138	149	163	157	607
Per common share					
Net earnings					
Basic	0.11	0.48	0.08	0.08	0.72
Diluted	0.11	0.47	0.08	0.08	0.72

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Historical summary – December 31, 2002 (In millions of Canadian dollars, unless otherwise noted)

Historical Summary

	2002 $	2001 $	2000 $	1999 $	1998 $	1997 $	1996 $	1995 $	1994 $	1993 $	1992 $
OPERATIONS											
Net sales	**5,490**	4,377	3,598	3,067	2,348	1,938	1,977	2,206	1,596	1,287	1,270
Operating expenses	**5,106**	4,064	3,122	2,688	2,148	1,882	1,868	1,697	1,469	1,324	1,344
Operating profit (loss) before unusual items	**384**	313	476	379	200	56	109	509	127	(37)	(74)
Unusual items and other expenses											
Unusual items	**–**	–	–	–	–	–	35	–	(27)	–	19
Financing expenses (1)	**192**	167	119	76	123	65	32	87	156	148	147
Premium and write-off on early redemption of long-term debt	**–**	–	–	–	–	–	127	–	–	–	–
Gain on contribution to Norampac, including amortization of deferred gain	**(5)**	(5)	(5)	(5)	(5)	(25)	–	–	–	–	–
Income tax expense (recovery) (1)	**56**	11	100	123	31	3	(23)	153	2	(69)	(91)
Non-controlling interest	**–**	–	–	(1)	(2)	(2)	(1)	6	–	–	–
Earnings (loss) from continuing operations (1)	**141**	140	262	186	53	15	(61)	263	(4)	(116)	(149)
Discontinued operations, net of income taxes	**–**	–	–	–	–	–	184	65	67	(4)	(36)
Net earnings (loss) (1)	**141**	140	262	186	53	15	123	328	63	(120)	(185)
FINANCIAL POSITION											
Assets											
Cash, short-term investments and deposits	**38**	36	29	3	9	283	44	286	319	115	42
Other current assets	**1,138**	1,132	999	843	788	567	593	710	575	548	557
Property, plant and equipment	**5,387**	5,612	3,002	2,978	3,010	1,964	1,992	2,086	1,809	1,898	1,955
Goodwill	**79**	62	65	65	66	65	20	21	14	19	25
Other assets	**205**	213	140	116	108	66	58	46	52	56	51
Total assets	**6,847**	7,055	4,235	4,005	3,981	2,945	2,707	3,149	2,769	2,636	2,630
Liabilities and shareholders' equity											
Current liabilities	**854**	810	629	604	683	397	396	416	367	338	465
Long-term debt	**2,444**	2,883	984	1,041	1,158	863	635	1,082	1,220	1,204	976
Future income taxes (1)	**625**	528	559	371	252	206	209	225	72	47	104
Other liabilities and deferred credits and non-controlling interest	**370**	408	254	207	232	189	156	175	183	179	182
Equity element of convertible debentures	**–**	–	–	–	–	–	–	99	93	88	–
Preferred shares	**44**	48	51	54	87	100	103	216	219	222	225
Common shareholders' equity (1)	**2,510**	2,378	1,758	1,728	1,569	1,190	1,208	936	615	558	678
Total liabilities and shareholders' equity	**6,847**	7,055	4,235	4,005	3,981	2,945	2,707	3,149	2,769	2,636	2,630

CASH FLOWS											
Operating											
Cash flows provided from (used for) operating activities (1)	**677**	727	587	326	248	125	172	520	166	14	(86)
Investing											
Net additions to property, plant and equipment	**(223)**	(280)	(248)	(206)	(206)	(153)	(351)	(361)	(212)	(88)	(61)
Acquisition of businesses	**(27)**	(2,616)	(22)	(9)	(456)	–	–	(88)	–	–	–
Net consideration received upon contribution to Norampac	**–**	–	–	–	–	285	–	–	–	–	–
Net proceeds from business divestitures	**–**	–	–	–	–	–	604	–	297	28	–
Other	**1**	(5)	(12)	28	(1)	7	(19)	233	(249)	(11)	(2)
Financing											
Dividend payments	**(33)**	(28)	(28)	(28)	(25)	(23)	(17)	(5)	(3)	(3)	(7)
Long-term debt and equity financing	**21**	4,289	–	5	676	–	360	4	3	365	350
Change in bank indebtedness	**(25)**	(2)	(1)	17	(4)	15	(12)	10	16	(6)	4
Change in revolving bank credit	**9**	(196)	(163)	198	3	–	–	(89)	(21)	(25)	(194)
Change in short-term financing	**–**	–	–	–	–	–	–	–	–	–	–
Redemption, repayments and other	**(398)**	(1,882)	(87)	(337)	(509)	(17)	(979)	(31)	(16)	(195)	(86)
Net increase (decrease) in cash and cash equivalents	**2**	7	26	(6)	(274)	239	(242)	193	(19)	79	(82)
OTHER DATA											
Per common share											
Earnings (loss) from continuing operations (1 & 2)	**0.62**	0.72	1.42	1.00	0.31	0.09	(0.50)	1.99	(0.08)	(0.94)	(1.27)
Net earnings (loss) (1 & 2)	**0.62**	0.72	1.42	1.00	0.31	0.09	0.87	2.50	0.45	(0.97)	(1.57)
Cash dividends declared	**0.14**	0.14	0.14	0.14	0.14	0.14	0.14	–	–	–	–
Year-end book value	**11.02**	10.51	9.75	9.39	8.56	7.96	8.03	7.32	4.83	4.39	5.37
Market price — Toronto Stock Exchange											
High	**17.80**	16.46	22.00	18.75	12.70	13.50	12.70	14.75	10.13	9.25	8.38
Low	**13.83**	11.00	9.90	8.60	6.80	8.85	9.00	9.25	6.50	4.88	4.25
Ratios											
Return on common shareholders' equity (1 & 3)	**6%**	7%	15%	11%	4%	1%	11%	41%	10%	(20)%	(27)%
Net debt-to-total-capitalization ratio (1 & 4)	**49:51**	55:45	37:63	38:62	43:57	33:67	32:68	40:60	50:50	56:44	55:45
Other statistics											
Number of common shareholders	**5,589**	5,773	6,034	6,477	7,076	7,254	8,732	9,347	10,303	10,868	11,284
Number of preferred shareholders	**236**	273	301	351	390	418	485	555	624	704	806
Common shares outstanding (millions)	**227.7**	226.2	180.4	184.1	183.4	149.5	150.4	127.8	127.4	127.1	126.2
Number of employees (5)	**12,000**	12,500	9,155	8,232	7,946	7,300	7,574	9,503	9,821	9,821	10,270
Salaries, wages and benefits (5)	**1,056**	821	611	544	414	461	462	550	562	562	564

(1) The 1992 to 2001 figures have been restated to reflect the impact of amended CICA recommendations related to the accounting for foreign currency translation.

(2) The 1997 results include the after-tax impact of the gain on contribution to Norampac of $0.11 per share. The 1996, 1994, and 1992 results include the after-tax impact of unusual items of $(0.17), $0.11 and $(0.11) per share, respectively.

(3) The 1997 figures exclude a non-recurring $17 million after-tax gain realized on the contribution of Domtar's packaging net assets to Norampac. The 1996 figures exclude non-recurring items related to the divestitures of the Gypsum and Decorative Panels divisions, a charge related to the refinancing program completed during the year and a charge principally related to asset write-downs.

(4) Ratio of long-term debt and bank indebtedness, including retractable preferred shares for the year 1991, net of cash, short-term investments and short-term deposits held in trust to total capitalization.

(5) All data subsequent to 1997 exclude Norampac. All data prior to 1998 include 100% of Domtar's packaging division, although it was contributed to Norampac on December 30, 1997. The 1998 data for salaries, wages and benefits includes only five months of E.B. Eddy whereas the data for number of employees includes all employees of E.B. Eddy as at December 31, 1998. The 2000 data for salaries, wages and benefits includes only five months of Ris Paper whereas the data for number of employees includes all employees of Ris Paper as at December 31, 2000. The 2001 data for salaries, wages and benefits includes only five months of the four integrated pulp and paper mills acquired from Georgia-Pacific Corporation whereas the data for number of employees includes all employees of the four integrated pulp and paper mills acquired from Georgia-Pacific Corporation as at December 31, 2001.

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Shareholder and investor information

Annual meeting
The Annual Meeting of Shareholders will be held at 1:30 p.m. on Thursday, May 1, 2003, at the Mount Royal Centre, Montréal, Qc, Canada.

Annual information form
The Annual Information Form may be obtained by writing to the Secretary of Domtar Inc. at the Head Office.

Transfer agents and registrars
For Common and Series "A" and "B" Preferred Shares and Debentures:
Computershare Trust Company of Canada – Halifax, NS; Montréal, QC; Toronto, ON; Calgary, AB; Vancouver, BC

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Shareholders wishing to receive dividends in U.S. dollars may obtain detailed information by communicating with Computershare Trust Company of Canada at:
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Ticker Symbol: DTC

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Shareholder services
Shareholders having inquiries concerning their shares or debentures, or wishing to obtain information about the Corporation should contact:

Computershare Trust Company of Canada
Shareholder Services
1500 University Street
Suite 700
Montréal, Qc, Canada H3A 3S8
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Tel.: (514) 848-5400

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Communications and
Government Relations Department
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www.domtar.com

The Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee is composed of five (5) directors, all of whom are outside unrelated directors.

The mandate of the Committee is to:

- recommend annually to the Board proposed candidates suitable for election or re-election to the Board;
- review and evaluate periodically the performance and contribution of each director and the effectiveness of the Board as a whole;
- review annually the compensation of the directors in their capacity as directors, and make recommendations to the Board in this respect;
- review periodically the mandates and performance of the committees of the Board and review annually the membership and chairs of the committees, and make recommendations to the Board in this respect;
- monitor the system of corporate governance of the Corporation; and
- advise the Board and the committees of the Board on corporate governance issues.

The Committee met three times in 2002.

The Environment and Health and Safety Committee

The Environment and Health and Safety Committee is composed of four (4) directors, three (3) of whom are outside unrelated directors, and one (1) of whom is an inside related director. The mandate of the Committee is to review the policy, management plans, programs, practices and performance of the Corporation in light of applicable environment and health and safety legislative requirements, assess the performance of the Corporation in these areas, and make recommendation to the Board.

The Committee met twice in 2002.

The Pension Committee

The Pension Committee is composed of five (5) directors, three (3) of whom are outside unrelated directors, one (1) is an inside related director and one (1) is an outside related director.

The mandate of the Committee is to:

- approve the investment policy of the pension funds and the benchmarks used to measure the performance of the pension funds;
- recommend annually to the Board, for its approval, the funding policy for the pension funds;
- approve the hiring of the external portfolio managers and their objectives, and evaluate the performance of the external and internal portfolio managers;
- approve assumptions used in valuations of the pension funds and review reports therein; and
- recommend to the Board, for its approval, amendments to the pension plans.

The Committee met twice in 2002.

The Board has established the following committees:

The Executive Committee

The Executive Committee is composed of six (6) directors, five (5) of whom are outside unrelated directors, and one (1) of whom is an inside related director. Except as otherwise provided by law and by the administrative resolutions of the Corporation, this Committee may exercise all the powers of the Board of Directors. In practice, however, the Committee acts only with respect to specific matters delegated to it by the Board of Directors, the principal one being the review of projects of a strategic nature. Its approval level is limited to investments not exceeding $10 million. The Committee met three times in 2002.

The Audit Committee

The Audit Committee is composed of five (5) directors, all of whom are outside unrelated directors.

The mandate of the Committee is to:

- review, prior to submission to the Board, all financial information and financial statements of the Corporation and the external auditors' report thereon;
- review with the external and internal auditors of the Corporation the arrangements for and scope of each proposed audit of the accounting records and report to the Board any significant reservations the Committee may have or the external or internal auditors may have expressed with respect to such arrangements or scope;
- review periodically with the Corporation's external and internal auditors their respective activities and the nature of their respective recommendations and report on same at least annually to the Board;
- evaluate the performance of the external auditors, review their fees, and make recommendations to the Board in this respect;
- evaluate annually the organization, independence and efficiency of the internal auditors; and
- review periodically the Code of Ethics of the Corporation, and its adherence by Management.

The Committee met twelve times in 2002.

The Human Resources Committee

The Human Resources Committee is composed of five (5) directors, all of whom are outside unrelated directors.

The mandate of the Committee is to:

- review the human resources policies of the Corporation;
- approve the engagement and termination, and the promotion and compensation of the members of the Management Committee of the Corporation, and the engagement of all officers of the Corporation, except for the Chief Executive Officer and the Chief Operating Officer of the Corporation, in respect of whom the Committee makes recommendation to the Board; and
- review annually, or as needed, the succession planning for the Chief Executive Officer and the Chief Operating Officer, the senior management of the Corporation and their direct reports.

The Committee met three times in 2002.

The board should adopt a charter for the audit committee that sets out roles and responsibilities of the audit committee, which should be specifically defined so as to provide appropriate guidance to audit committee members as to their duties.

The mandate (charter) of the Audit Committee is specifically defined by Board resolution and is summarized below under the heading "The Audit Committee".

The audit committee should have direct communication channels with the internal and external auditors to discuss and review specific issues as appropriate.

The Audit Committee mandate (charter) provides that the Committee will, at least quarterly, meet with the external auditors and the Director, Internal Audit, to discuss and review specific issues as appropriate.

The audit committee duties should include oversight responsibility for management reporting on internal control. While it is management's responsibility to design and implement an effective system of internal control, it is the responsibility of the audit committee to ensure that management has done so.

The Audit Committee, which has oversight responsibility for management reporting on internal controls and disclosure controls, requires that management implement and maintain appropriate internal control and disclosure control procedures. The Committee meets with the Director, Internal Audit, and corporate finance management to assess the adequacy and effectiveness of these systems of internal control.

14. The board should implement a system to enable an individual director to engage an outside advisor, at Domtar's expense, in appropriate circumstances. The engagement of the outside advisor should be subject to the approval of an appropriate committee of the board.

Subject to the approval of the Nominating and Corporate Governance Committee, directors may retain outside advisors at Domtar's expense.

12. The board should implement structures and procedures to ensure that it can function independently of management. An appropriate structure would be to (i) appoint a chair of the board who is not a member of management with responsibility to ensure that the board discharges its responsibilities, or, (ii) assign this responsibility to an outside director, sometimes referred to as the "lead director".	The position of Chairman of the Board, which is a non-management position, and the position of Chief Executive Officer are separate and distinct. Mr. Jacques Girard has held the position of Chairman of the Board since August 1996, and Mr. Raymond Royer has held the position of President and Chief Executive Officer since September 1996. In October 2000, the Board created the position of Vice-Chairman of the Board, which is a non-management position, and Mr. Gilles Blondeau was appointed to that position.
The chair or lead director should ensure that the board carries out its responsibilities effectively which will involve the board meeting on a regular basis without management present and may involve assigning responsibility for administering the board's relationship to management to a committee of the board.	At all meetings of the Board and committees of the Board, an opportunity is provided to meet without any representatives of management being present. During 2002, the Board and Board committees held, in the aggregate, five such *in camera* sessions without any representatives of management being present. The Chairman also serves as a liaison among the directors and between the Board and the CEO.
13. The audit committee should be composed entirely of unrelated directors.	The Audit Committee is composed entirely of unrelated directors.
All the members of the audit committee should be financially literate and at least one member should have accounting or related financial expertise.	All members of the Audit Committee are financially literate and at least one member has accounting or related financial expertise.
The board shall determine the definition of and criteria for "financial literacy" and "accounting or related financial expertise".	In considering criteria for determination of financial literacy, accounting or related financial expertise, the Board looks at the ability to read and understand a balance sheet, an income statement and a cash-flow statement, or the ability to analyze a full set of financial statements, including notes in accordance with Canadian GAAP.

9. Subject to Guideline 13, committees of the board should generally be composed of outside directors, a majority of whom are unrelated.	The Audit Committee, the Nominating and Corporate Governance Committee, and the Human Resources Committee are composed entirely of outside and unrelated directors.
10. The board should assume responsibility for, or assign to a committee of directors responsibility for, developing the approach to corporate governance issues.	The Nominating and Corporate Governance Committee has the general responsibility to monitor the system of corporate governance of the Corporation and to advise the Board on related issues.
This committee would, among other things, be responsible for the response to the TSX guidelines.	The Nominating and Corporate Governance and the Board of Directors have reviewed and approved Domtar's response to the TSX guidelines.
11. The board of directors, together with the CEO, should develop position descriptions for the board and for the CEO, including the definition of the limits to management's responsibilities.	The Board approved the position description of the CEO. The by-laws of the Corporation and the administrative resolutions adopted by the Board specify the limits of authority of the CEO and management. Every year, the Corporation's objectives and initiatives are reviewed by the Board as part of the annual budget process that form the priorities of management for the year.
The board should approve or develop the corporate objectives which the CEO is responsible for meeting and assess the CEO against these objectives.	The Board approves the CEO's objectives annually and evaluates his performance against these objectives.

5. The board should implement a process, to be carried out by an appropriate committee, for assessing the effectiveness of the board, its committees and the contribution of individual directors.

A process for assessing the effectiveness of the Board, its committees, and the individual directors has always existed. The Chairman of the Board bears this responsibility along with the Nominating and Corporate Governance Committee (see also Guideline 4).

6. The corporation should provide an orientation and education program for new directors.

Domtar provides the directors with an education program that focuses on the corporate governance system, including the roles, responsibilities and liabilities of directors and regular presentations on Domtar's operations. New directors receive an orientation program that is part of the corporate governance system. From time to time, Board meetings are held at plant sites, and visits are organized for directors.

7. The board should examine its size and undertake, where appropriate, a program to establish a board size that facilitates effective decision-making.

The Board of Directors is of the view that its size and composition are well suited to the circumstances of the Corporation and allow for the efficient functioning of the Board of Directors as a decision-making body. In 2002, the number of directors was reduced from 16 to 13 directors.

8. The board of directors should review the adequacy and form of compensation of directors in light of the risks and responsibilities involved in being a director.

The Nominating and Corporate Governance Committee has the mandate to review annually the compensation of directors. In making recommendations to the Board for appropriate adjustments, the Committee considers the time commitment, risks and responsibilities of directors, as well as comparative data derived from surveys of board compensation at other companies prepared by an independent outside consultant.

vi integrity of internal control and management information systems.

The Audit Committee requires management to implement and maintain appropriate systems of internal control and disclosure control, and meets regularly with the Director, Internal Audit, the external auditors and with Domtar management to assess the adequacy and effectiveness of these systems (see also Guideline 13). As required by SOX, the CEO and CFO have provided certificates relating to the contents of the annual statutory reports and have evaluated and reported on the effectiveness of Domtar's internal controls and disclosure controls and procedures.

2. **A majority of directors should be "unrelated" (independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act with a view to the best interests of the corporation).**

The Board of Directors is of the view that its directors are unrelated directors, except for Mr. Claude Fontaine, who is a senior partner of a law firm that provides legal services to the Corporation on a regular basis, and Mr. Raymond Royer, President and Chief Executive Officer of the Corporation.

3. **The board has responsibility for applying the definition of "unrelated director" to each individual director and for disclosing annually the analysis of the application of the principles supporting this definition and whether the board has a majority of unrelated directors.**

Based on its analysis and information provided by the directors as to their circumstances, the Board has determined that two of the persons proposed for election to the Board at this year's Annual Shareholders' Meeting are "related" to Domtar (see Guideline 2).

4. **The board should appoint a committee of directors composed exclusively of outside directors, a majority of whom are unrelated directors, with responsibility for proposing new nominees to the board and for assessing directors on an ongoing basis.**

The Nominating and Corporate Governance Committee is composed exclusively of non-management directors, all of whom are "unrelated" to Domtar. The Committee has the mandate to recommend candidates for the Board and its committees and to review and evaluate the performance and contribution of all directors.

iv) communication policy;

The Board reviews and approves the contents of major disclosure documents, including the Annual Information Form, Management's Discussion and Analysis, press releases in connection with quarterly and annual financial results, and the Management Proxy Circular. The Board has approved the Disclosure Policy, which addresses how Domtar interacts with analysts and the public and contains measures to avoid selective disclosure. The Corporation has also a Code of Ethics that contains all its principal policies.

In this regard:

- procedures are in place to provide timely information to investors and potential investors and to respond to investor inquiries and concerns;
- an investor relations service is maintained with the responsibility to maintain communications with the investing public in accordance with Domtar's policies and procedures and legal disclosure requirements;
- the CEO, CFO and other senior executives meet periodically with financial analysts and institutional investors;
- investor relations staff is also available to shareholders by telephone and fax, and Domtar maintains a comprehensive investor relations Web site at www.domtar.com;
- quarterly earnings conference calls are broadcast live over the Internet, and are accessible on a live and recorded basis. Presentations at investor conferences are promptly made available on the Internet.

i) adoption of a strategic planning process and approval of a strategic plan that takes into account, among other things, the opportunities and risks of the business;

The Board approves Domtar's strategic direction that takes into account, among other things, the opportunities and risks of the business. In addition, at the time of annual budget, the key assumptions underlying the strategic plan and the business factors/risks are reviewed and updated. Through the strategic planning process and the annual budget exercise, the Corporation has the mechanisms to identify the principal risks that could affect its business and to implement risk-managing systems.

ii) identification of the principal risks of the corporation's business and ensuring implementation of appropriate systems to manage those risks;

The Board has established committees to implement and monitor systems put in place to assess these risks. For instance, the Executive Committee reviews projects of a strategic nature prior to the submission to the Board; the Audit Committee reviews and monitors internal controls and disclosure controls; the Environment and Health and Safety Committee monitors the operations of the environmental and occupational health and safety management systems. The CEO, the CFO and the heads of the operating groups report quarterly to the Board. Mill visits are regularly conducted by the Board members.

iii) succession planning, including appointing, training and monitoring senior management;

The mandate of the Human Resources Committee includes the review of succession planning for members of the Management Committee on an annual basis. The CEO reviews annually with the Human Resources Committee and the Board his assessment of his direct reports, who constitute the Management Committee, and the succession plan for these positions. A performance management evaluation program is in place to assist in identifying high potential employees.

Statement of Corporate Governance

Companies listed on the Toronto Stock Exchange ("TSX") have to disclose, on an annual basis, their approach to corporate governance and the conformity of their practices with the *Guidelines for Improved Corporate Governance* ("Guidelines") issued by the TSX. These guidelines deal, among other things, with the responsibilities of directors, the constitution of the Board and committees of the Board, and Board practices.

Domtar's corporate governance system, adopted by the Board of Directors since 1997, is compared with the Toronto Stock Exchange ("TSX") *Guidelines for Improved Corporate Governance*, including amendments published in the spring of 2002 and not yet formally implemented as of February 27, 2003. In December 2002, the TSX circulated a further set of proposed, amended guidelines. The Board will review Domtar's corporate governance practices when these amended guidelines are finalized.

The Board has been reviewing its corporate governance practices in response to the United States *Sarbanex-Oxley Act of 2002* ("SOX"), as well as the New York Stock Exchange corporate governance rule proposals ("NYSE Proposals"). The U.S. *Securities and Exchange Commission* ("SEC") is in the process of issuing rules and regulations to give effect to the provisions of SOX, and it is currently considering approval of the NYSE Proposals. Domtar's intention is to comply with SOX and the NYSE Proposals and, as they come into effect, the Board will review its governance procedures.

This Statement also contains summaries of the mandates of the committees of the Board.

1. The board should explicitly assume responsibility for stewardship of the corporation

According to the *Canada Business Corporations Act*, the Corporation's governing statute, the business and affairs of the Corporation are managed under the supervision of its Board of Directors. The Board approves the management philosophy, assesses management's execution and reviews the results obtained. Its duties include, among others, approval of strategic plans, review of corporate risks identified by management and the Corporations's practices and policies for dealing with these risks, management succession planning, and assessment of the integrity of the Corporation's internal and disclosure controls and information systems.

and specifically for:

Board of Directors

Gilles Blondeau
Montréal
Vice-Chairman of the Board of Domtar Inc.
Chairman of the Board and Chief Executive Officer of Optimum Group Inc.

Paul-Henri Couture
Montréal
Vice-President of Capital d'Amérique CDPQ Inc., a wholly owned subsidiary of Caisse de dépôt et placement du Québec

Claude Fontaine
Montréal
Senior Partner of Ogilvy Renault

Louis P. Gignac
Montréal
President and Chief Executive Officer of Cambior Inc.

Jacques Girard
Montréal
Chairman of the Board of Domtar Inc.
President and Chief Executive Officer of Montréal International

Claude R. Lamoureux
Toronto
President and Chief Executive Officer of the Ontario Teachers' Pension Plan Board

Jacques Laurent
Montréal
Chairman of the Board of Hydro-Québec

André L'Ecuyer
Québec
President and Chief Operating Officer of SGF Rexfor Inc., a wholly owned subsidiary of Société générale de financement du Québec

Brian M. Levitt
Montréal
Co-Chair and Partner of Osler, Hoskin & Harcourt

Louiselle Paquin
Montréal
Senior Vice-President, Finance of SITQ Immobilier, a group of subsidiaries of Caisse de dépôt et placement du Québec

Louise Roy
Montréal
Corporate Director

Raymond Royer
Montréal
President and Chief Executive Officer of Domtar Inc.

Edward J. Waters
Darien, Connecticut
Chairman and President and Chief Executive Officer of Cape & Islands Investment Company Ltd.

Committees

Executive	Audit	Human Resources	Nominating and Corporate Governance	Environment and Health and Safety	Pension
G. Blondeau	L. P. Gignac*	G. Blondeau	G. Blondeau	J. Laurent	C. Fontaine
P.-H. Couture	C. R. Lamoureux	P.-H. Couture	J. Girard*	A. L'Ecuyer*	J. Girard
J. Girard*	J. Laurent	J. Girard*	C. R. Lamoureux	L. Roy	C. R. Lamoureux*
C. R. Lamoureux	B. M. Levitt	A. L'Ecuyer	J. Laurent	R. Royer	R. Royer
A. L'Ecuyer	L. Paquin	B. M. Levitt	E. J. Waters		E. J. Waters
R. Royer					

* Chairman of the Committee


And your Board of Directors?
Present!
— Jacques Girard
Chairman of the Board

everywhere

Head office

1 Domtar House

Pulp and paper mills

2 Ashdown
3 Cornwall
4 Espanola
5 Lebel-sur-Quévillon
6 Nekoosa
7 Ottawa-Hull
8 Port Edwards
9 Port Huron
10 Vancouver
11 Windsor
12 Woodland

Converting centers

13 Ottawa
14 Terrebonne

Sales offices

15 Atlanta
16 Chicago
17 Cincinnati
18 Dallas
19 Los Angeles
20 Montréal
21 New York
22 Ottawa
23 Port Huron
24 Toronto
25 Vancouver

Domtar Paper Merchants

26 Albany
27 Baltimore
28 Boston
29 Cincinnati
30 Cleveland
31 Columbus
32 Dallas
33 Dartmouth
34 Dayton
35 Fort Wayne
36 Harrisburg
37 Hartford
38 Indianapolis
39 Lancaster
40 London
41 Mansfield
42 Montréal
43 New York
44 Ottawa
45 Philadelphia
46 Québec
47 Saint John
48 South Bend
49 St. John's
50 Toronto
51 Washington, DC

In addition to the Domtar Paper Merchants, some 150 independant paper merchants, in more than 350 locations throughout North America, carry Domtar papers.

Wood

52 Chapleau
53 Elk Lake
54 Grand-Remous
55 Lebel-sur-Quévillon
56 Malartic
57 Matagami
58 Nairn Centre
59 Ste-Aurélie
60 Ste-Marie
61 Sullivan
62 Timmins
63 Val-d'Or
64 White River

we are here and our products are

Improve our productivity	Ongoing. And always will be. If we don't, our competitors will	Implemented best practices Reviewed capabilities of all paper machines Qualified paper machines for new grades to ensure greater flexibility Introduced integrated planning of production Discontinued certain products Re-allocated manufacturing of paper grades Permanently closed three paper machines Improved inventory turnover and reduced working capital Combined timber and lumber operations into a single group Closed two facilities within the Wood segment	Fully implement integrated production planning process in order to better respond to customer needs Deploy single Enterprise Resource Planning IT system in the Papers segment Continue to improve quality and reduce waste by tapping into knowledge and commitment of employees through Kaïzen continuous improvement workshops
Achieve US$65 million in acquisition-related synergies	Exceeded. Annualized run-rate reached US$80 million at end of 2002		
Improve profitability by $100 million by the end of 2003	On-track		
Continue our good citizenship	Ongoing. And always will be. It's the only way to ensure that our business is sustainable	Participated in the development of Forest Stewardship Council standards for the Canadian boreal forest Donated property with ancestral burial ground to Maine's Passamaquoddy tribe Obtained Sustainable Forest Initiative certification for wood procurement practices at U.S. mills Obtained ISO 14001 certification at Woodland mill Launched new line of Forest Stewardship Council certified papers	Continue forest certification efforts Further use less fiber to manufacture lumber Improve energy efficiency of paper mills Develop, according to customer demand, additional Forest Stewardship Council certified products Complete ISO 14001 certification of all pulp and paper mills
Maintain our financial return edge	Ongoing. And always will be. Domtar is now one of the best performing paper companies in North America. We now strive to be one of the best performing companies in the Basic Materials sector	Increased operating margin Delivered higher than industry average return on equity Limited capital expenditures to 56% of annual amortization Generated significant free cash flow Reduced net debt to less than 50% of total capitalization Maintained investment grade credit rating Outperformed all major stock indices Included for fourth consecutive year in the Dow Jones Sustainability Group Index	Continue to limit capital expenditures to 75% of annual amortization Reduce net debt to below 45% of total capitalization Continue to seek for acquisitions, joint ventures and other opportunities that respond to customer needs and create value for shareholders

“Where do we stand on our five objectives announced in 2001?”

	Where do we stand?	What did we do in 2002?	What next?
Enhance customer loyalty	Ongoing. And always will be, given our customer focus	Revised brand strategy and names of products Simplified paper offering Reduced stock keeping units Developed 30 new products Launched a single 1-800 number to service customers for all paper products	Migrate four IT customer service applications onto a single platform in order to service customers more quickly and efficiently Redesign packaging of papers to strengthen brand recognition and ensure better product identification and protection Develop some 20 new products
Double our size	Partially done. And we will continue increasing our critical mass	Integrated four mills acquired in 2001 Optimized Ris Paper, our U.S.-based paper merchant acquired in 2000	Continue to seek acquisitions, joint ventures and other opportunities that respond to customer needs and create value for shareholders

What. And for whom.

We manufacture, market and sell lumber and value-added lumber. In addition to making dimensional lumber and studs, we manufacture lumber graded according to recognized standards, such as Premium, J grade and MSR. Through a joint venture called Anthony-Domtar, a partnership we created with Anthony Forest Products of Arkansas, we manufacture a unique engineered wood product: Power JoIst™. Our lumber products are used mostly in the building or remodeling of homes and other structures. End-users purchase our products either at home improvement centers or through wholesalers and distributors. Slightly more than half of our production is sold in the Eastern United States, while the remainder is sold in Eastern Canada.

How much. How and where.

We are able to make up to 1.2 billion board feet of lumber every year. Our eleven sawmills, one re-manufacturing facility and one planer mill are located in the provinces of Ontario and Québec. All our sawmills are certified according to ISO 9002 standards. We have a partnership with the Cree First Nation of Waswanipi, owning a 45% interest in the Nabakatuk sawmill in Québec. Power JoIst™ is made at a facility in Sault Ste. Marie, Ontario.

We directly manage more than 22 million acres of forestland, so we can supply our mills with the fiber they need. Forest operations are located in the provinces of Ontario and Québec, and in the states of Maine and New York. In order to ensure sustainability, forest management practices on these lands are certified according to ISO 14001 or Forest Stewardship Council standards, which require regular independent third-party verification of practices and processes. Domtar posts its forest management plans on a corporate website for public viewing and comment.

Approximately 2,500 employees work in or support our activities in the forest and at our sawmills.

wood

8%

of
annual
net sales

What. And for whom.

Norampac inc., our joint venture with Cascades inc., is the largest containerboard producer in Canada and the seventh largest in North America. Created in 1997, Norampac is also a major Canadian manufacturer of corrugated products. We like to say that Norampac is not a provider of boxes, but a provider of packaging solutions. Norampac can produce plain boxes as well as complicated packaging systems including design and structural analysis. The food and beverage industry is by far the largest segment of Norampac's customer base, followed by industrial manufacturers of durable and non-durable goods. Norampac also offers a recycling program that covers everything from paper to box production. The company prides itself on its ability to deliver high-quality products that meet all manner of customer needs.

How much. How and where.

Domtar owns 50% of Norampac, but does not manage this business day-to-day. Our joint venture consists of eight corrugated mills and twenty-five corrugated product mills in Canada, the United States, Mexico and France. Norampac's annual production capacity exceeds 1.6 million tons. More than 4,700 employees work for Norampac.

packaging

11%

of
annual
net sales

What. And for whom.

Domtar owns paper merchants in North America: Buntin Reid, JBR / La Maison du Papier and The Paper House in Canada, and Ris Paper in the United States. Our merchants buy, warehouse, market, sell and deliver our business and commercial printing and publication papers. In addition to Domtar products, they offer customers papers from other manufacturers, graphic arts supplies, and certain industrial products. Our merchants supply to a diverse range of customers, primarily corporate offices and commercial printers, large and small.

How much. How and where.

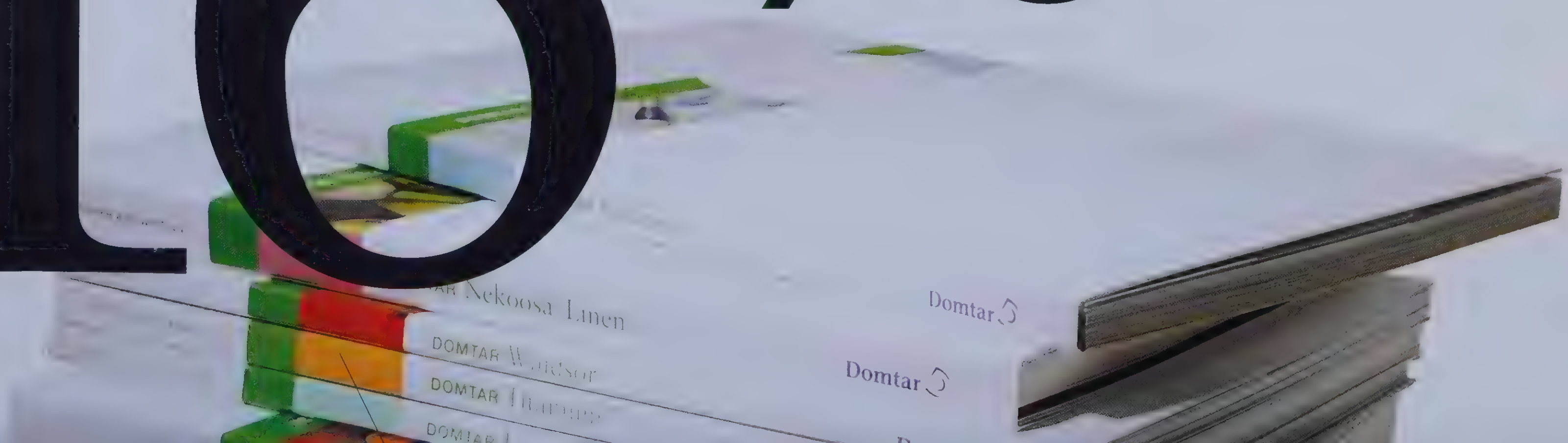
Approximately 30% of all papers sold by our merchants throughout North America are Domtar products. Our Canadian paper merchant has eight branches in Eastern Canada, while our American merchant serves a large client base from twenty locations in the Northeast, Midwest and Mid-Atlantic regions of the United States. Approximately 1,000 employees are involved in this business.

* Excluding sales of Domtar papers.

paper merchants

16%*

of
annual
net sales



“We should have put a picture here... but what for? Our paper is already in your hands.”

(In fact, this annual report is printed on two of our well-known papers.)

What. And for whom.

We make three categories of papers: business, commercial printing and publication, and technical and specialty.

Business papers are for copiers, color copiers, inkjet printers, and laser printers. We also make papers for conversion into forms, envelopes and repositionable note pads. They are principally for home or office use. They reach our end-users either through retail outlets, office equipment manufacturers or paper merchants and represent about 36% of our annual production.

Commercial printing and publication papers are generally used for stationery, pamphlets, brochures, annual reports, books, catalogues and magazines. They may be coated or uncoated to provide different finishes. These papers are sold to commercial printers and publishers through paper merchants or directly. Design papers, a sub-group of this category, are primarily utilized for special brochures and annual reports. Each paper has distinct features: color, brightness, texture, etc. Targeted towards graphic artists in design and advertising agencies, they are sold to commercial printers by paper merchants. This category represents approximately 50% of our annual production.

Technical and specialty papers are for such unique applications as food and candy wrappings, surgical gowns and wallpapers among others. They are often created in partnership with product manufacturers and sold to them directly. These represent about 14% of our annual production.

How much. How and where.

Domtar can manufacture some 2.8 million tons of paper each year. We have eleven pulp and paper mills: six in Canada and five in the United States. All our mills, except Vancouver, are certified ISO 9001 or 9002. All our mills will be certified ISO 14001 by the end of 2003. In addition to making all the pulp necessary to supply all our mills, we sell pulp to third parties.

Our main sales offices are in Atlanta, Chicago, Cincinnati, Dallas, Montréal, New York, Ottawa, Toronto, Los Angeles, Vancouver and Port Huron. We have three customer service call centers located in Atlanta, Montréal and Ottawa. In addition to the Domtar Paper Merchants, some 150 independent paper merchants, in more than 350 locations throughout North America, carry Domtar papers. Approximately 8,300 employees are involved in the making, marketing and selling of our papers.

* Including sales of Domtar papers through our own Paper Merchants Group.

papers

65%*

of
annual
net sales

at our transformed company

Members of the Management Committee

From left to right:

C. Lance Skerratt
Senior Vice-President
Paper Merchants Group

Richard Garneau
Senior Vice-President
Forest Products Group

Gilles Pharand
Senior Vice-President
Corporate Affairs,
General Counsel and Secretary

Christian Dubé
Senior Vice-President and
Chief Financial Officer

Roland Gagnon
Senior Vice-President
Canadian Pulp and Paper
Manufacturing Group

Raymond Royer
President and Chief Executive Officer

Claude Belley
Senior Vice-President
Human Resources and
Organizational Development

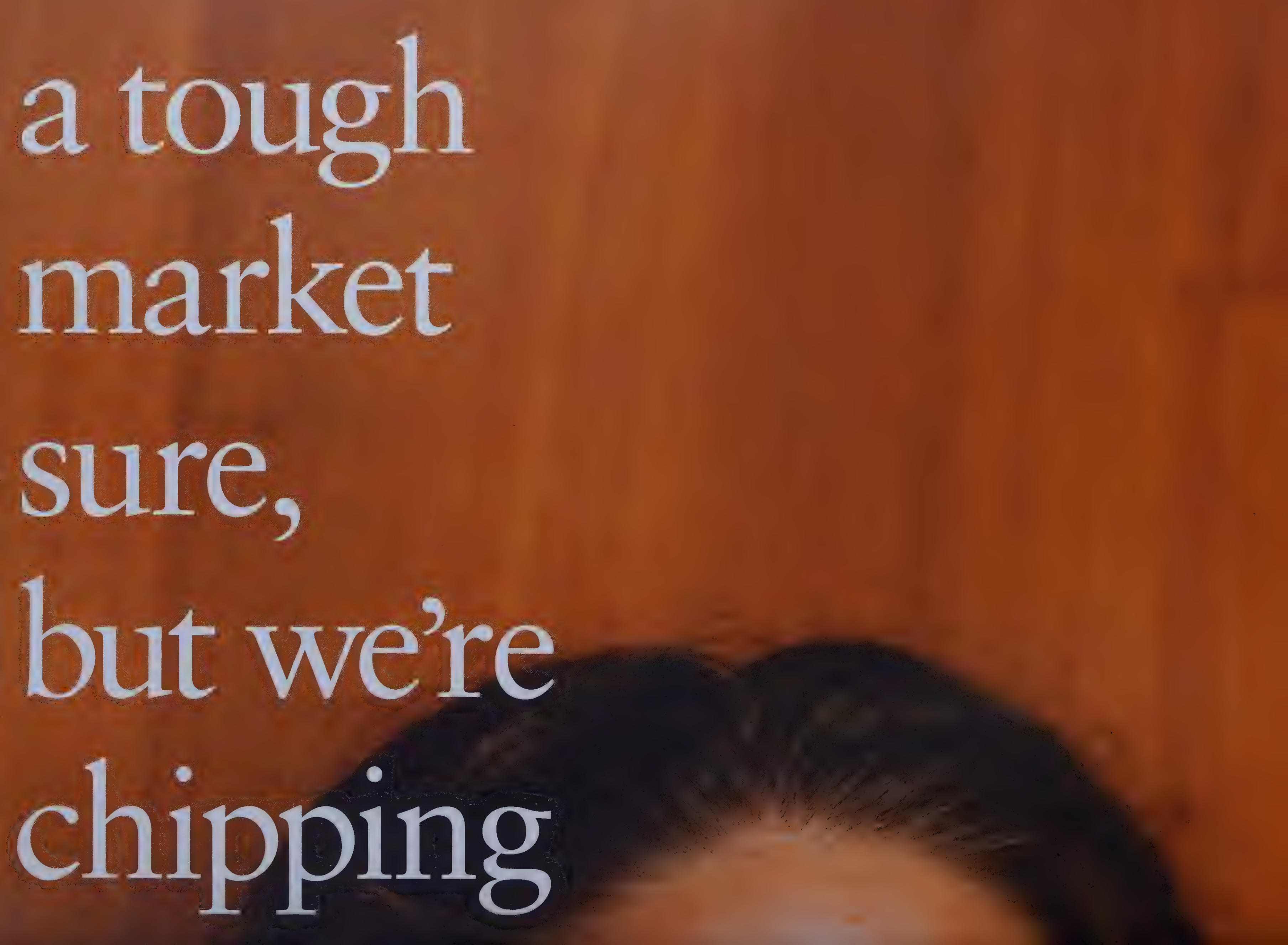
George Kobrynsky
Senior Vice-President
Pulp and Paper Sales, Marketing
and Customer Relations Group

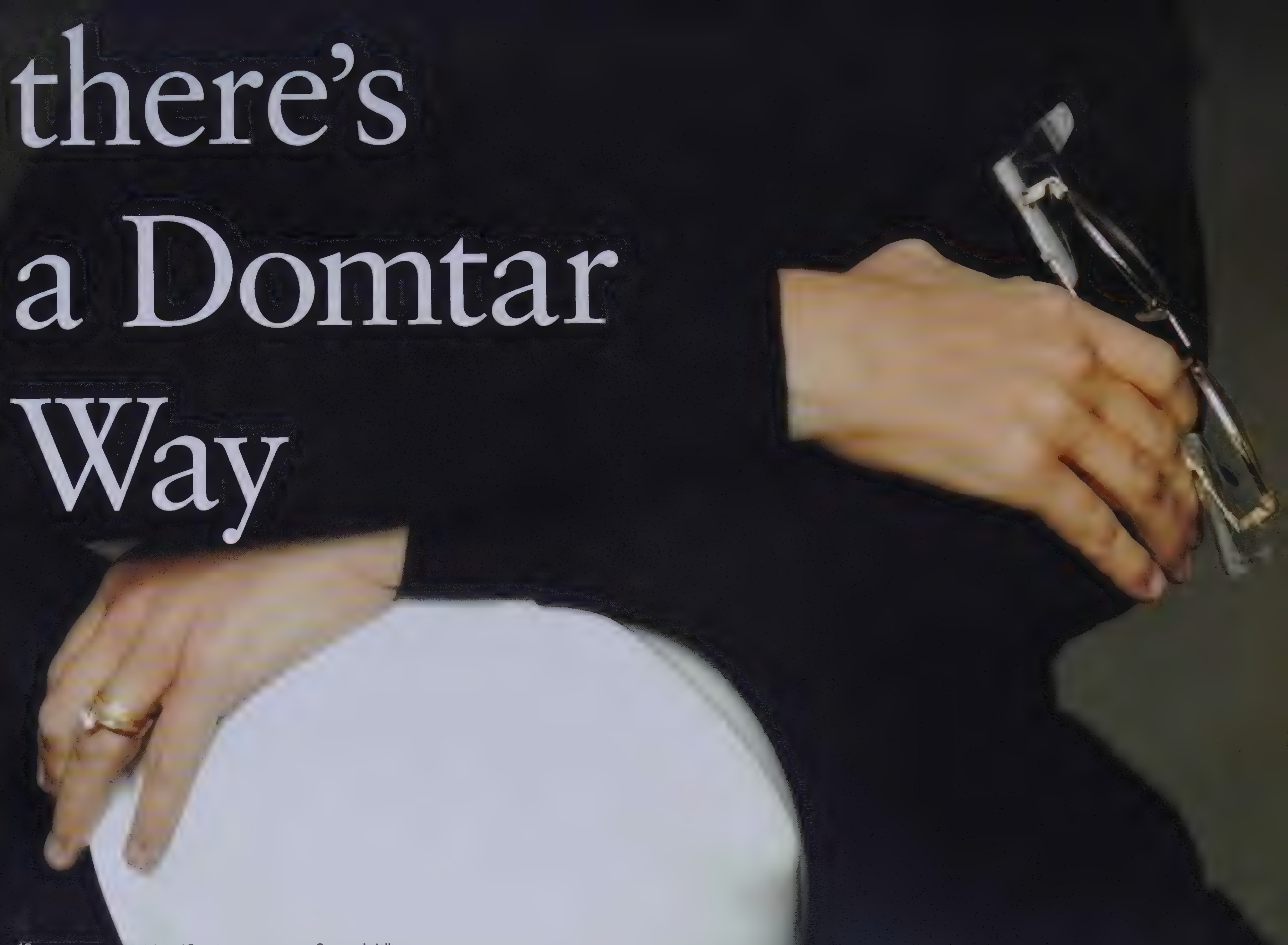
Roger H. Brear
Senior Vice-President
U.S. Pulp and Paper
Manufacturing Group

and now take a look

Jézabel Cloutier
Finance Manager
Forest Products Group

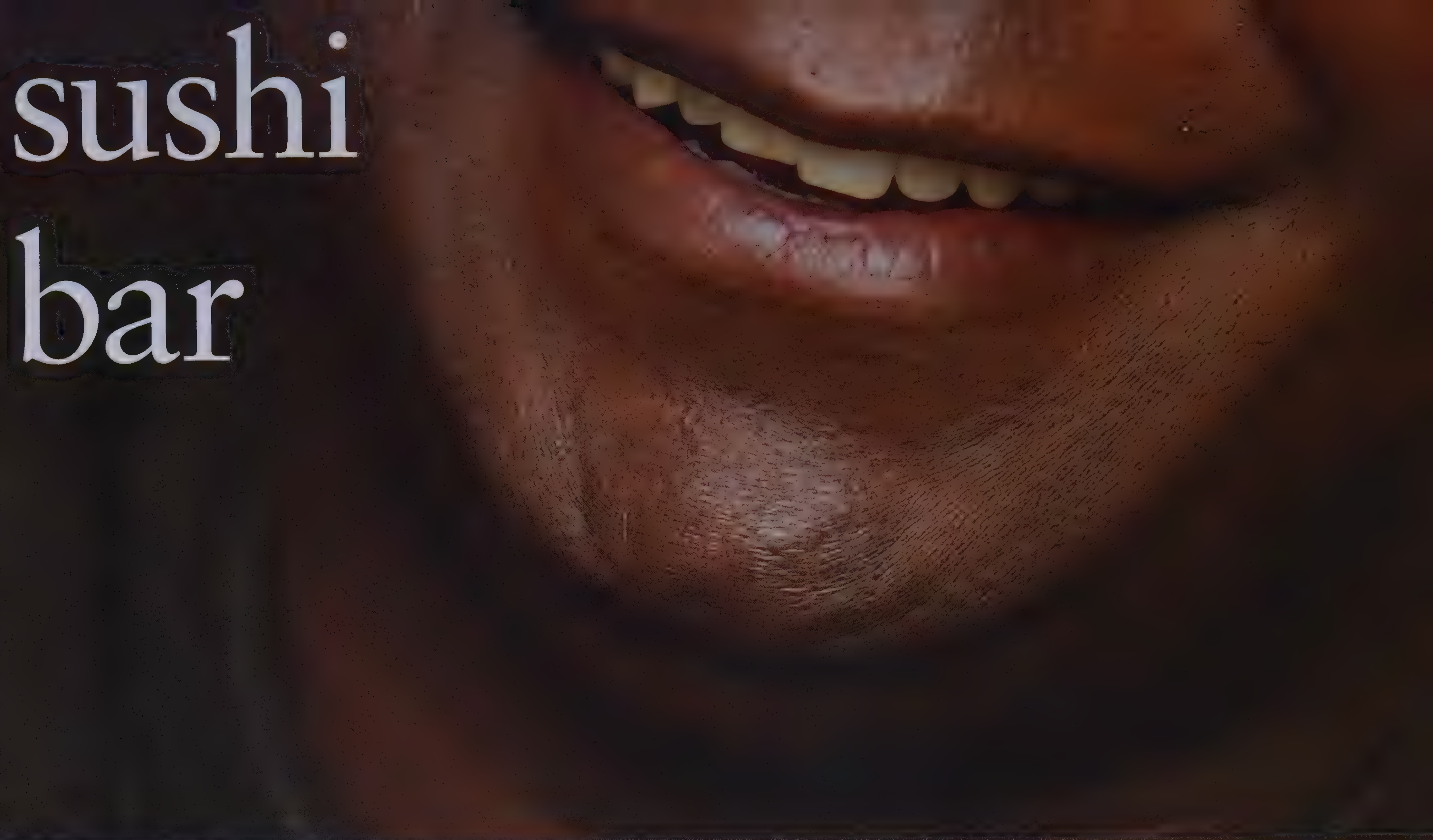
"It's been a difficult year in the Wood segment, with 27% duties on our softwood lumber exports to the U.S. plus low pricing. Consequently, we embarked on cost reduction initiatives. Our reorganization of the way we source fiber, notably for our Nairn Centre, Val d'Or and Lebel-sur-Quévillon sawmills, resulted in significant cost savings. We also introduced a new Enterprise Resource Planning system and added new sawing equipment, improving our response to customer needs and enabling us to manufacture more high quality lumber with much less waste."


a tough
market
sure,
but we're
chipping


there's
a Domtar
Way

Debbie Feck
General Manager
Woodland Mill, Maine

"A better customer base and new paper grades without a doubt helped Woodland return to profitability. But no turnaround would have occurred had it not been for our ability to lower costs by US$12 million. As you can imagine, we reviewed everything we did. We ran ten Kaïzens with 100 employees. We found savings and implemented improvements in both procurement and manufacturing. Sure, we're proud of what we achieved, but we're even more proud to be part of a company that empowers its employees and its mills with such faith."



Madison C. Brown
Manager, Training and Organization Development and Kaïzen Coordinator
Ashdown Mill, Arkansas

"I've been with the Ashdown Mill for three years. We used different initiatives to improve quality in the past, but none proved as effective or more rewarding than Domtar's Kaïzen Continuous Improvement Workshops. Since I became Kaïzen Coordinator, we've run over twelve workshops involving some 150 employees. We've addressed important operational issues with repeated success, such as reducing natural gas consumption in our power area by more than 20% and reducing waste on our converting sheeters by 1.5%, and we achieved each of these results without hiring a single consultant. Undoubtedly, the crowning achievement has been the involvement of our employees to implement their ideas and expertise. Their efforts in Kaïzen have saved our mill US$1.7 million since the inception of the program in March 2002, and it continues to grow."

Kaïzen. It's not another trendy


veni,
vidi...
audi
(They came,
they saw...
they listened)

Steve Abbott

Manager, Power and Recovery
Nekoosa and Port Edwards
Mills, Wisconsin

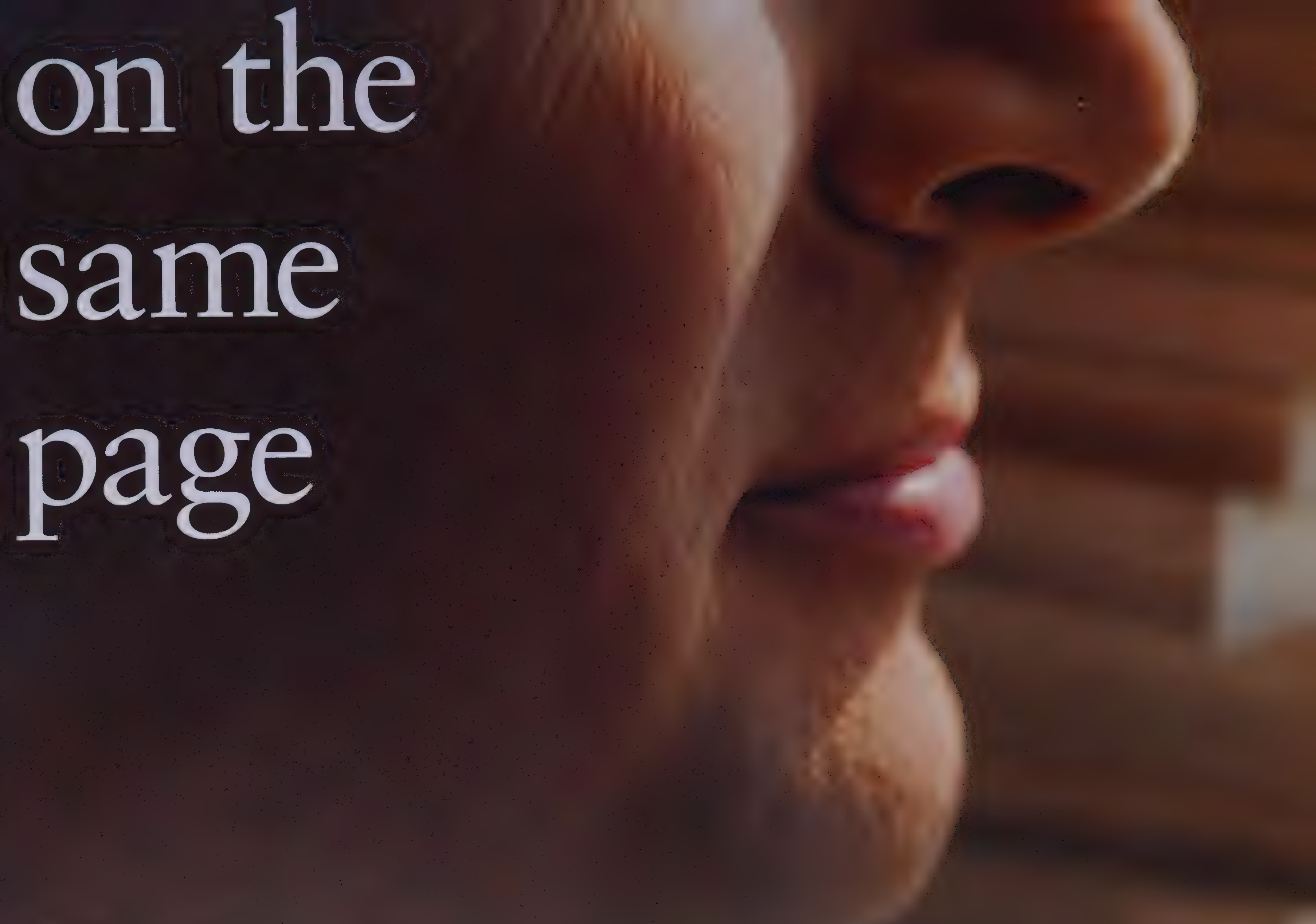
"Being bought usually means being conquered, but that's not the Domtar way. Right after the acquisition, a working group and 26 sub-groups, with equal representation from both existing and new mills, were created. The task was to identify best practices throughout our new company. I headed up an energy sub-group. We worked fast, well, left no stone unturned and met with almost immediate success. Amazingly, we found that we could save over US$1 million each year by sharing our knowledge on how to run our equipment in a more energy-efficient way, like running boilers with lower excess oxygen and applying that method at each mill. As a bonus, we fostered an instant network of colleagues that has been growing ever since. Time and time again we proved over that period that small things do make a difference. But more importantly, we proved that everybody counts".

Andrea Day
Manager, New Product Development, Business Papers Pulp and Paper Sales, Marketing and Customer Relations Group

"We study markets, anticipate trends and develop creative partnerships. In fact, this approach helps us develop and market some 20 new products every year. In 2002, Domtar became the only company in North America to manufacture and sell, as regular stock items, papers to meet the social and environmental standards of the Forest Stewardship Council. Actually, these products would never have seen the light of day had it not been for our longstanding partnership with World Wildlife Fund–Canada to expand protected forest areas, now committed to promoting our FSC-certified papers to a rapidly growing number of environmentally conscious corporations."


new
partners,
new
needs,
new

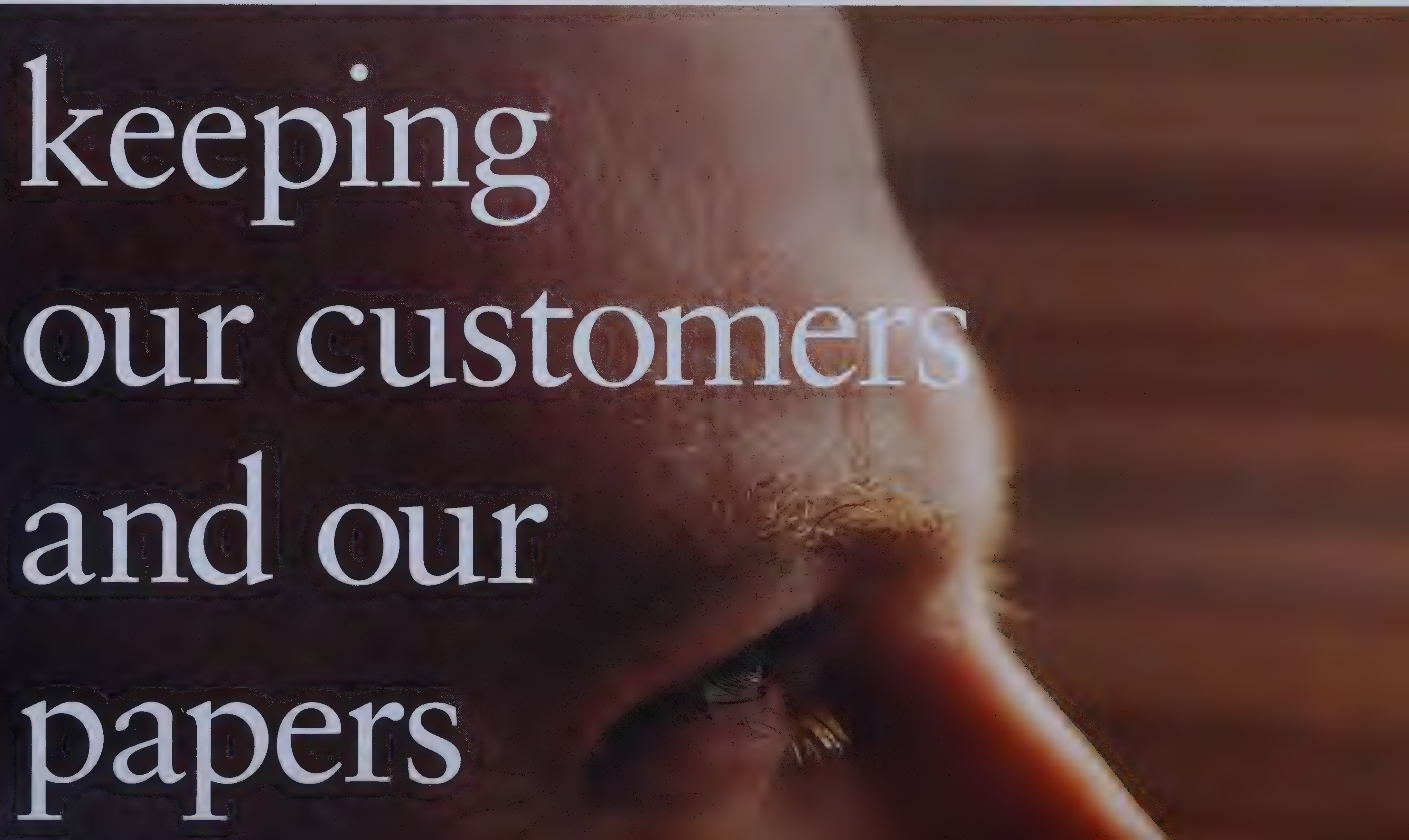
on the same page



Mark Conti

Group Product Manager –
Coated Papers,
Pulp and Paper Sales,
Marketing and Customer
Relations Group

"Range and depth in a product offering is a real plus, but according to our customers, simplicity is supreme. So, given our responsiveness, we reviewed every line and product. The end result is one brand, three lines of papers, 26 sub-brands rather than 54, plus some 40% fewer Stock Keeping Units (SKUs). It's a simplified offering, and, combined with our just-in-time deliveries, it translates into easier ordering and less inventory for our customers. Yet, it allows them, more than ever before, to tackle any task."



"Domtar needs to keep on growing"

Despite having almost tripled our size since 1997, Domtar still remains a medium-sized player with a market capitalization of just over $3.5 billion. To attract investor interest, Domtar needs to keep on growing. Of course, such growth would have to follow the principles established in 1997. We have to achieve our objective of delivering at least a 15% return on equity when prices are at trend, and maintain a strong balance sheet, with a debt-to-capitalization ratio that under normal circumstances should be lower than 45%. As in the past, any future acquisitions will be judged on whether they increase Domtar's customer appeal, whether they are in line with Domtar's expertise and know-how, and whether they increase shareholder value from day one.

In closing, we wish to thank the members of the Board of Directors, which plays an active role in the governance and in ensuring transparency in the management of our Company. Directors review the information provided to them to properly assess decisions that impact on the future of Domtar and our ability to provide shareholders with superior returns. Members of the Board of Directors and the Management Committee work together, while respecting each other's roles and responsibilities. We are grateful for their constructive contribution. Without a doubt, their expertise and advice have been crucial to our growth.

We cannot close this letter without expressing our deep gratitude to Domtar's three pillars: our customers, for their loyal support, our employees, for their creativity, commitment and professionalism in helping Domtar earn a preferred status in the new basic materials index, and you, our shareholders, for your continued confidence.

Raymond Royer
President and Chief Executive Officer

Jacques Girard
Chairman of the Board

We are also pleased that Domtar stock has been included in the Dow Jones Sustainability Group Index for the fourth consecutive year. Domtar is now the only North American pulp and paper company retained in this index.

Finally, credit rating agencies recognized Domtar's ability to meet its debt reduction targets, and issued opinion updates during 2002 on our investment grade status with a stable outlook.

"We are aiming to be one of the most attractive investments in the basic materials sectors"

What's next for Domtar?

While our current industry environment is beset with challenges beyond our control – the increase in energy costs and the fluctuation of the US dollar, to name just two – we remain confident that our financial rigor and approach will help us mitigate these risks. Our strategy applied rigorously since 1997 has worked to make Domtar one of North America's largest and best performing paper manufacturers. And while this is a great start, it is just the beginning. We are aiming to be one of the most attractive investments in the Canadian and American basic materials sectors.

We have already begun benchmarking our performance against a select group of companies, which we consider the best. Several key indicators suggest we are on the right track. Our return on equity over the past three years, for example, has been higher than the basic materials average. Similarly, our ability to generate free cash flow per common share compares very favorably with the best in the sector.

The above two examples show how Domtar employees met the year's challenges head on and prevailed. As a result, we are proud to report that all our paper mills recorded profits in 2002.

While it represents just 8% of total sales, our Wood segment remains an important challenge. The imposition of countervailing and antidumping duties on Canadian softwood lumber exported to the U.S. has had an impact on market conditions. Some Canadian producers responded with significant increases in production in an attempt to reduce unit costs. As supply far outstripped demand, prices dropped in 2002 as much as 25% below trend prices for a business cycle. To alleviate the impact of this difficult environment, which is likely to continue for several more quarters, we created a new Forest Products Group combining both timber and lumber operations. We also launched an additional cost-cutting initiative, and temporarily closed certain mills. Following extensive market analyses, we also shut down two unprofitable operations, in Daveluyville, Québec and Sault Ste. Marie, Ontario. We will continue to make every effort to find lasting solutions for the Wood segment, which, under normal market conditions, should generate profits.

We faced difficult challenges in the Papers and Wood segments last year that made it necessary to let some personnel go. In keeping with Domtar values, every employee affected by the closures was treated with respect and dignity. For those who wished to stay, we made every effort to re-locate them within the Domtar organization. Others received financial assistance and professional services to help them find other employment. Since so much of our success is a direct result of employee dedication and loyalty, we believe shareholders will fully support these actions. Our aim was to strike the right balance between taking necessary decisions to improve our financial performance and reassuring employees that Domtar will always treat them fairly.

Markets appreciate our performance

We are satisfied with the fact that our stock largely held its value throughout 2002, given that leading indicators suffered important declines. The Dow Jones, for example, fell 17%, while the Standard & Poor's 500 Index (S&P) dropped a full 23%. The S&P sub-index of U.S. pulp and paper companies dropped an average of 19%, with the S&P Index of basic materials companies falling 8%. Domtar's performance in this environment leads us to believe that the market supports our actions, especially our decision to apply a major portion of our free cash flow to paying down debt.

In effect, over the past five years, Domtar has experienced a steady decline in demand for text, writing and cover papers, which are used mainly by graphic designers. In response to this trend, we decided to examine the long-term viability of a mill in St. Catharines, Ontario, and a paper machine at the Nekoosa mill in Wisconsin. In spite of employee efforts to improve efficiency, the facts were clear. Domtar faced low demand for products made on three high-cost machines that were difficult to adapt. We therefore decided to permanently shut down this capacity, which reduced our pool of machines to 28. Many products manufactured on these machines were discontinued, while others were transferred to more cost-effective machines, notably at our Nekoosa and Port Edwards mills in Wisconsin. This decision, the more difficult because it involved laying-off employees, enabled us to stem a decade of losses in St. Catharines, and also optimized our two Wisconsin mills.

Increasing Asian competition, attracted to North America by a strong US dollar, urged us to review our activities at our Vancouver mill as well. We decided to dedicate production at this mill to the manufacturing of our coated sheet, Domtar Luna. The Woodland pulp and paper mill in Maine, acquired in 2001, also posed a major challenge having turned in only two profitable years in the past ten. However, the introduction of our Kaïzen continuous improvement programs and the remarkable efforts of our Woodland employees returned the mill to profitability, despite a difficult pricing environment.

“So much of our success is a direct result of employee dedication and loyalty”

"Domtar. A different feel"

As part of our effort to anticipate the needs of our customers and offer them innovative and long-lasting competitive advantages, we reviewed our entire approach to sales and marketing. The result is a new strategy that showcases the Domtar brand rather than specific products, and underscores our promise to "out-service" the competition. It introduces a new corporate tagline – "Domtar. A different feel".

The decision to master brand Domtar's offering and elevate service to the same prominence as product, clearly differentiates Domtar in the marketplace. At the same time, it should allow us to more easily integrate products resulting from future acquisitions. Response to the Company's repositioning and product streamlining has been outstanding, with positive reactions from customers and in particular paper merchants. They appreciate our efforts to simplify our product offering, which facilitates, in turn, ordering and inventory management.

Committed to continuous improvement

During 2002, we were able to demonstrate once again the level of professionalism and discipline in the integration of acquisitions.

Indeed, all of us at Domtar respect the knowledge and experience of our employees within any newly acquired business, and we know enough to resist the temptation of imposing our own ideas and ways. Instead, each time we complete an acquisition we set-up working groups for each operational area. Their mandate is to identify best practices and implement them throughout the Company in order to improve our efficiency as well as the quality of our products and services.

This approach once again proved highly effective in 2002, during the integration of the four mills acquired in 2001. Our goal at the time was to achieve US$65 million in acquisition-related synergies. With unprecedented commitment from our employees, we exceeded our target. In fact, our annualized run-rate at the end of 2002 reached US$80 million, which was translated into permanent improvements to our cost structure. In addition to these synergies, we continued our quality and profitability improvement program. At the beginning of 2002, our stated goal was to reduce costs and improve margins by a further $100 million by the end of 2003. Year-end results show that we are in line with our objective.

Our pursuit of excellence encourages us to thoroughly analyze trends and evaluate opportunities. It also requires us, in some cases, to make difficult but necessary decisions such as the permanent closure of facilities. We also conducted a detailed study of the capabilities of all our 31 paper machines so we could qualify them for different categories of paper and re-shuffle grades according to market conditions.

"As part of our effort to anticipate the needs of our customers we reviewed our entire approach to sales and marketing"

Since 1997, we have adopted a new policy that limits capital expenditures to our annual amortization. Before we commit to any such expenditure, projects must pass several key tests to demonstrate that they will create value. Not surprisingly, our employees rose to the occasion, taking on more tasks with less capital. Stimulated by the challenge of finding creative ways to meet our quality and productivity targets, our employees helped us generate cash flows that compare favorably with those reported by others in the paper and forest products industry, as well as those included in the basic materials index. As a result, and despite the difficult economic environment, our free cash flow in 2002 reached $454 million or $2 per common share.

"All of us at Domtar respect the knowledge and experience of our employees within any newly acquired business"

"Even more noteworthy is the increase in our operating margin"

Solid performance in 2002

Domtar benefited from a full twelve months of sales from the four acquired U.S. mills, compared to five months in 2001, which increased our net sales by 25% to $5.5 billion, even though our product prices were 4% lower than in 2001 and 7% lower than trend prices for a business cycle.

Our net earnings before mill closure costs stood at $183 million, generating a 7% return on equity or 6% after mill closure costs. This performance exceeds the industry average return.

Even more noteworthy is the increase in our operating margin, which rose to 8.1% (before mill closure costs), compared to 7.1% in 2001, despite the low pricing environment. This improvement, combined with a disciplined approach to capital expenditures – only 56% of amortization in 2002, or well below our 75% target – helped us meet another key commitment, which is debt reduction.

Our debt ratio was a matter of concern upon completing the acquisition of the four U.S. mills. As such, we had undertaken to reduce our net debt-to-total-capitalization ratio to 50% or below by the end of 2002 and, on December 31, this ratio stood at 49%. This accomplishment highlights our disciplined approach towards capital expenditures and cash flow, given that the ratio was 65% at the time we acquired the four U.S. mills.

"This has indeed been a pivotal year for Domtar"

Dear fellow shareholders,

We take great pride in presenting our accomplishments for 2002, confident that once you have read this report, you will agree that this has indeed been a pivotal year for Domtar. We had to prove to the three pillars of our Company – our employees, our customers, and our shareholders – that the new Domtar, strengthened by the acquisition of four U.S. mills in August 2001, responded to their respective interests and expectations.

Indeed, we had to show our new employees in the U.S. that the management philosophy we described during the acquisition is the same we put into action in our mills. We had to show our customers that the design and manufacturing synergies gained through our acquisition would provide them with a lasting competitive advantage. And we had to show our shareholders that we had fulfilled our promises to them in terms of synergies, cost improvements and debt reduction. We also wanted to prove that Domtar could occupy a privileged position in the basic materials index.

As a reminder, we announced in 1997 a three-pronged strategy to enable us to become one of the most profitable paper companies in North America. The plan has three main elements: understand and meet the needs of our customers, continuously improve the productivity of our mills and the quality of our products and services, and increase our activities in our area of expertise. This strategy has resulted in our becoming the largest Canadian paper company in terms of sales and the third-largest manufacturer of uncoated freesheet in North America.

This report summarizes our accomplishments in 2002 and outlines our short- and medium-term plans for the new Domtar.


It's simple.
Our people
and our way.
— Raymond Royer
President and Chief Executive Officer

Highlights

(In millions of Canadian dollars, unless otherwise noted)

	2002 US$[2]	**2002**	2001 Restated[1]	2000 Restated[1]	1999 Restated[1]	1998 Restated[1]
Operating results						
Net sales	3,476	**5,490**	4,377	3,598	3,067	2,348
EBITDA	512	**809**	607	715	608	384
Operating profit	243	**384**	313	476	379	200
Net earnings	89	**141**	140	262	186	53
Weighted average number of common shares outstanding (millions)	227.2	**227.2**	191.2	182.9	183.9	163.4
Net earnings per common share	0.39	**0.62**	0.72	1.42	1.00	0.31
Balance sheet data						
Total assets	4,335	**6,847**	7,055	4,235	4,005	3,981
Net debt-to-total-capitalization (%)[3]	49	**49**	55	37	38	43
Year-end book value per common share	6.98	**11.02**	10.51	9.75	9.39	8.56
Cash flows						
Free cash flow	288	**454**	447	339	120	42
Free cash flow per common share	1.27	**2.00**	2.34	1.85	0.65	0.26
Value creation						
Return on common shareholders' equity (ROE) (%)	6	**6**	7	15	11	4
Selling price index (%)	93	**93**	97	102	93	94

(1) The 1998 to 2001 comparative figures have been restated to reflect the effect of the adoption of the amended Canadian Institute of Chartered Accountants recommendations regarding foreign currency translation.

(2) For the convenience of the reader, the 2002 "Highlights" have been translated into US dollars at the year-end rate of CAN$1.5796 = US$1.00.

(3) Ratio of long-term debt and bank indebtedness (net of cash and cash equivalents) to total capitalization.

Just how did Domtar achieve so much in 2002?

See reverse for Financial section

Cover page:
Marc Picard, Account Service Manager, Mid-America market, Customer Service


Domtar.
A Different
Feel.
Just how did
Domtar achieve
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